OVERSIGHT ON CIVIL AERONAUTICS BOARD

HEARING

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-SIXTH CONGRESS

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ON

OVERSIGHT ON CIVIL AERONAUTICS BOARD—FARE FLEXIBILITY ZONE REGULATION

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OVERSIGHT ON CIVIL AERONAUTICS BOARD

Fare Flexibility Zone Regulation

TUESDAY, MAY 20, 1980

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON AVIATION,
Washington, D.C.

The subcommittee met at 10 a.m. in room 235, Russell Senate Office Building, Hon. Howard W. Cannon (chairman of the committee) presiding.

OPENING STATEMENT BY THE CHAIRMAN

The CHAIRMAN. Good morning. This morning's oversight hearing is for the purpose of examining the CAB decision last week to permit expanded fare flexibility. The Board's interim decision, already effective, is to permit unlimited fare increases in markets up to 200 miles; to permit increases of up to 50 percent above the standard fare level in markets of 201 to 400 miles; and to permit increases of up to 30 percent above the standard fare level in markets of more than 400 miles.

I am skeptical about the economic justification for this uneven application of fare protection. I am even more concerned about the obvious appearance of discriminatory protection, and the reaction we are already beginning to hear from small communities with low density, short haul markets.

I look forward to the chairman's explanation of the record the Board developed in adopting this interim rule. I would appreciate knowing the groups or individuals which have advocated this policy of nonuniform fare ceilings. The majority of comments the committee has received from carriers and communities alike have been that fare flexibility should be provided evenly for all markets.

Finally, I am concerned that the Board is adopting its own schedule for deregulation in lieu of the legislative schedule carefully worked out by the Congress. The proposal in question is little short of the deregulation of air fares, which the Board justifies with the assertion the entry and route authority have already been deregulated.

I disagree. There are both legal and practical barriers to entry, and the fact that we have eliminated the legal barriers is not synonymous with eliminating the shock of doubling fuel prices; the lack of available capacity for commuter carriers; the lack of new technology, highly efficient capacity among the larger air carriers; and simply the adjustment of people in the industry who have experience with 40 years of regulation. I don't believe that 1 year

and 7 months have wiped out those very real practical barriers to relying upon actual and potential entry as the policeman on upward pricing.

I hope the Board means what it says in labeling this rule as an interim regulation. I hope the CAB is aware that the definition of interim is consistent with a regulation which exists a matter of days, and that the Board realizes that reconsideration is an important element of sound decisionmaking.

Now, our first witness this morning will be my colleague, the majority leader, Senator Robert Byrd.

Senator, we are delighted to have you here with us and delighted to hear from you this morning.

STATEMENT OF HON. ROBERT C. BYRD, U.S. SENATOR FROM WEST VIRGINIA

Senator BYRD. Thank you, Mr. Chairman.

Thank you for the opportunity to appear before you today to express my dismay, as you have just expressed your dismay, over last week's decision of the Civil Aeronautics Board.

That decision virtually removed all regulatory restraints from shorthaul air transportation flights. In a nutshell, that means airlines can charge any rates they see fit on flights of less than 200 miles. I am appalled at this decision—appalled because it invites the airlines to raise air fares which have increased steadily since airline deregulation went into effect in 1978.

This decision by the CAB effectively discriminates against the shorthaul markets. Under the Board's new policy, all regulatory control has been removed from flights of less than 200 miles, but regulatory protection is retained for longer routes.

The CAB's order states that airlines can boost air fares up to 50 percent in markets of 200 to 400 miles long, and fares can be increased by up to 30 percent in markets exceeding 400 miles.

The obvious question is: Why protect the longhaul routes and not the shorthaul trips?

It also appears that the Board is accelerating unnecessarily the timetable for removing these regulatory restraints. The Air Transportation Regulatory Reform Act of 1978 specifies January 1983 as the date when the CAB relinquishes all authority from ratesetting. That deadline is more than 2½ years away.

Deregulation has not been in effect long enough for airlines to shore up on the ingredients needed for better service—accessibility of fuel, availability of suitable airplanes, and airport accessibility.

I also question the rationale of the CAB in making this decision. The Board based its decision on the conclusion—and I am now quoting from the agency's own news release—"that competitive forces will keep fares in check and that a ceiling is no longer required."

I am bewildered over this reference to competitive forces. It is on these shorthaul trips that competition is lacking. If I want to fly from Charleston, W. Va. to Cincinnati, Ohio, there is only one airline to which I can turn.

The same can be said for most points within West Virginia, and in fact for most interstate points across the country. This is not a local phenomenon, it exists all over the Nation. And, all too often

poor road maintenance, unpredictable weather conditions, inadequate bus service, and inadequate train service eliminate the alternative of effective surface transportation.

Instead of alluding to nonexistent competition, the CAB should note that shorthaul markets more realistically approach monopolistic situations. And we all know what occurs when a monopoly exists—prices go up.

So, I am apprehensive that this latest directive from the CAB will lead to even higher air fares—putting air transportation out of the reach of most Americans.

Congress enacted airline deregulation in 1978 as a curb to inflation, in hopes that it would result in more efficient airline service, conducted in a freer environment, and because of increased competition, lower air fares.

To date the evidence points to many instances of deterioration of service for community airports and their customers.

Airports in small- to medium-sized communities across the country have lost 9,000 airline seats per week since deregulation took effect. West Virginia, which was hardest hit with a loss of 3,000 weekly airline seats, does not stand alone. Many States, Arizona, Nebraska, Idaho, Oregon, and Tennessee, to name just a few, also have suffered at the hands of airline deregulation. Most of the New England States, I am told, Maine, New Hampshire, Connecticut and Vermont have had a significant deterioration in air service amid our new deregulated atmosphere.

And, in addition to this loss of service, air fares have already skyrocketed. The cost of flying from West Virginia's State capital, Charleston, to Pittsburgh, Pa.—a point where many travelers make connections—a trip of less than 200 miles by air—has jumped 77 percent following deregulation.

From Charleston to Morgantown, W. Va., the State's educational center, air fares are up 58 percent.

When I fly back to Charleston from the Nation's capital, it costs me 77 percent more today than it did before airline deregulation took effect.

I am informed just now by a note handed to me by a member of my staff, that the fare has increased again, it is $162. So, instead of costing me 77 percent more today, it costs me 84 percent more today than it did before airline deregulation took effect.

In announcing its decision, the CAB stated that it would monitor the industry's performance and "would take action to reduce fares if abuses of market power were demonstrated."

I support this watchdog rule by the CAB. I have been disappointed, however, by the results of airline deregulation. The deregulated atmosphere was supposed to have blessed us with numerous benefits, including better service and lower fares. Instead, in many instances we have suffered from loss of airline seats and skyrocketing rates.

There is a need to insure that adequate air service, as provided under the law, is available. I believe an integral part of adequate air service is fair rates. We cannot afford to price our citizens and our communities out of the airline market.

Mr. Chairman, I applaud your effort in arranging these oversight hearings regarding the role of the CAB, and I appreciate the opportunity to share my concerns over the future of air transportation.

The CHAIRMAN. Thank you very much, Senator Byrd. This committee is, of course, very concerned. And we are aware of the fact that airline fares have gone up. But, we are aware also of the fact that the average increase in fares is about a third that of the increase in costs for the entire industry for the past year, or a little over a year.

So, there are arguments to be made on both sides. My concern is the discriminatory, apparent discriminatory action between the various lengths of market.

As I said in my opening statement, I think that there may be a question as to whether you should discriminate in the size of the markets, particularly when the people involved support an even-handed approach. At least that is the information that we get here.

We appreciate your testimony here and appreciate your being here.

Senator BYRD. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Stevens has asked me to read a statement of his for the record:

Mr. Chairman and members of the committee, I want to thank you for the opportunity to submit a statement regarding a recent decision by the CAB on the question of fare regulation.

As the members of the committee will recall, I served as the ranking minority member on the Aviation Subcommittee of the Commerce Committee throughout the consideration of the Airline Deregulation Act of 1978.

Although I felt compelled to leave the committee to join the Energy and Natural Resources Committee because of legislation of specific importance to Alaska, I maintain a great interest in the decision of the CAB as part of its implementation of the Airline Deregulation Act.

The recent decision of the Board, which essentially deregulates most air fares, troubles me. This committee spent a great deal of time and effort on the question of fare regulation during consideration of the Airline Deregulation Act. Yet, it seems to me the Board has chosen to ignore congressional action on this matter. We set up a specific zone of reasonableness based on the standard industry fare level. Further, we provided for adjustments to that fare level at least twice a year to deal with questions of increased costs.

The Board has ignored that legislative decision and is moving far too rapidly to permit major fare increases. The rising cost of operation, particularly those relating to cost of aviation fuel must be recognized, and I certainly believe that the airlines must have the opportunity to make a reasonable profit. But, it seems to me that the Board has simply ignored the intent of Congress in passing the Airline Deregulation Act.

Congress did not intend that fares be deregulated. It intended that the airlines have flexibility to adjust rates within a specified zone.

The action taken by the Board obliterates that zone and renders that section of the bill meaningless. That was not what we intended.

If a change in the basic provisions relating to fares is needed, then it is up to the Board or representatives of the administration to propose such changes to Congress.

Finally, let me state my total opposition to the application of this new fare system in Alaska. As I pointed out to this committee many times before, Alaska is unique and must be dealt with separately in regard to airline deregulation.

In my opinion there is not the level of competition necessary to depend solely on the competitive market to assure reasonable and affordable fares.

It is my understanding that the Board is now considering whether or not to apply the regulations to Alaska. This committee and the Congress has demonstrated an awareness of the unique air transportation needs of Alaska. There is a need for the exercise of regulatory powers in Alaska, regardless of whether these powers are exercised elsewhere.

I believe that fare adjustments which are fair to both the consumer and the airline industry, can be accomplished within the provisions of the Airline Deregulation Act.

Whether the Board would apply these fare regulations to Alaska would disregard congressional intent, and I ask the members of this committee to join me in urging the Board not to take such an action.

We will now hear from Chairman Cohen.

STATEMENT OF MARVIN S. COHEN, CHAIRMAN, CIVIL AERONAUTICS BOARD; ACCOMPANIED BY ELIZABETH BAILEY, MEMBER; ROBERT FRANK, DIRECTOR, OFFICE OF ECONOMIC ANALYSIS; AND MARY McINNIS, GENERAL COUNSEL

The CHAIRMAN. I see that the Chairman is accompanied by Betsy Bailey from the Board. We are delighted to have you both here.

Mr. COHEN. Thank you, Mr. Chairman. I brought my best resident economist along.

Mr. Chairman, I wonder if you might indulge me. Ordinarily when I testified here in the past, I have summarized my statement and taken as little time as I could to make my preliminary statement.

In light of the strong interest shown by you and the committee and the Senate, and I think the public, I wonder if I might be permitted to read my testimony entirely into the record.

The CHAIRMAN. Certainly.

Mr. COHEN. Mr. Chairman and members, in February and March 1977, the Civil Aeronautics Board under Chairman John Robson began a revolution by permitting the introduction of the Texas International "Peanuts Fares" and the American Airlines "Supersaver Fares."

Both proposed fares were opposed by the industry. Aithough the supersaver—at 40 percent off the normal coach fare was probably outside the range permitted under the Board's Domestic Passenger Fare Investigation, DPFI, criteria, it was approved because of the potential for public benefits.

When two of the Nation's leading market economists, Fred Kahn and Elizabeth Bailey, were appointed to the Board, they immediately began to pick up on the seeds of competition that had been

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sown and approved a series of discount fare proposals. This process culminated in the adoption of the fare flexibility rule PS-80 on September 3, 1978.

This rule was designed to stimulate market-by-market price competition by vacating DPFI requirements that coach fares be established uniformly on a mileage basis; that first-class fares be set at a fixed percentage above coach fares; and that discount fares be justified on the basis of the profit impact test.

Following the scheme outlined in the Senate deregulation bill, PS-80 established a suspend-free zone ranging from 70 percent below to 10 percent above the DPFI coach fare. This zone was incorporated into the Airline Deregulation Act of 1978 and made a major contribution to the expansion of price competition.

In addition, the act required the Board to adjust the DPFI fare level—renamed the Standard Industry Fare Level, SIFL, at least twice a year to reflect changes in actual industry costs.

Concurrently with the implementation of downward fare flexibility, the Board began an agonizing process of reassessing the economic merits of the competitive selection and limited entry route program that has been a hallmark of the agency for 40 years.

In a series of cases commencing in mid-1978, the Kahn-led Board reversed this 40-year history and adopted a program of multiple permissive awards.[1] Under this approach, all fit applicants would be granted authority regardless of whether an applicant actually intended to operate service in the market.

In adopting this approach the Board even rejected arguments by new entrants such as World Airways and Midway Airlines that they should be awarded a protective monopology corridor from incumbent competitors to help them get established in the marketplace.[2]

The Board concluded that if the new carriers had an innovative product to market, no special protection was required.

On June 1 of this year, Midway will be expanding its growing Chicago-based low-fare service to Washington, D.C., and World will be inaugurating new low-fare service from Washington-Baltimore, Newark, and Boston to London.

The Board rejected a more limited approach to a new entry because it feared that experimenting with route deregulation in a market here and there would cause serious market distortions. As long as there was the potential that permissive entry would only be temporary, the airlines would go into and expand service in marginal markets to preclude other entrants in the hope that during a long transition or if degregulation died, they would be able in the future to reap the benefits of monopoly power.

The solution, as Dr. Kahn stated, in his August 1978 address to the American Economic Association, was to demonstrate that the value of the franchise was going to be zero.[3]

He goes on to note:

> Then there will be no valuable pieces of paper to fight for the uneconomic operations, and no future monopoly gains to offset against the costs of present

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[1] *Oakland Service Case*, Order 78-9-96, *Improved Service to Wichita Case*, Order 78-12-106.

[2] Chicago-Midway Low Fare Proceeding, Order 78-07-40; Transcontinental Low Fare Route Proceeding, 79-1-75.

[3] Kahn, "Applications of Economics to an Imperfect World," Annual Meeting of the American Economic Association, August 26, 1978, Chicago p. 17.

predation. It is of course necessary to convince the companies that this is going to happen; but the way to do that is to open markets to free entry—and that is what we are doing. Moving as rapidly as possible to a system of universal free entry and exit—is the way also to deal with the asserted inequality of competitive abilities and opportunities during a slow transition; make the transition rapid, move quickly, on as broad a front as possible, to permit all carriers to throw off the restrictions that limit their operating flexibility, to leave the markets they find it uneconomic to serve, to enter the markets they want to enter.

The Board took these actions, Mr. Chairman, despite substantial opposition by the industry; and the multiple permissive awards policy was subsequently specifically endorsed by Congress when it passed the Airline Deregulation Act.

During 1978 and 1979 the Board issued multiple awards in hundreds of markets. Today virtually every airline holds authority to enter almost any market it might conceivably choose to operate.

And, if it does not have the authority in most cases following expedited procedures established under the new act, it can get it from the Board in 90 days.

In 1977, the trunk and local service carriers had in the aggregate 25,000 city-pair authorizations. Today they hold authority to serve well over 100,000 city-pair markets.

Under the new act, the Board's expansion of downward pricing freedom and its policy of liberal entry and exit served as a catapult to help boost the industry out of a 6-year recession—years of constantly rising fares and poor earnings.

Commuters were able to expand operations in short-haul markets and grew over 18 percent in 1979. Locals began to expand into longer haul routes and competition for leisure traffic became intense.

In 1978, a year of relatively stable fuel prices, a healthy economy and new competition, consumers saved over $2.5 billion through reduced air fares while the industry achieved record operating profits of over $1 billion, nearly double what they were in 1977.

During this same period, the Board went about the task of implementing the essential air service program. We established service criteria and sought replacement service when certificated carriers decided to vacate a market.

While there was some concern at first, the Board's program, including the transitional program for medium-sized communities like Bakersfield, has worked out well and, with a few exceptions, has drawn praise from all around the country.

This trend continued into mid-1979. Indeed, despite the fact that input costs for fuel, labor, aircraft, et cetera, has risen over 53 percent from year-end 1976 to year-end 1979, and the Consumer Price Index had climbed 31 percent, average air fares measured by yield per revenue ton-mile rose only 22 percent.

At the end of June 1979, before the dramatic jump in fuel prices, the average cost of an airline ticket in current dollars was the same as it was in December 1976. Very few, if any, other industries can demonstrate this kind of productivity gain.

Let's now turn to 1979, because it surely must be viewed as pivotal for the industry. Last year we witnessed the United strike, the Hughes Airwest, Ozark, Flying Tiger, and World strikes.

The grounding of the DC-10s has had a substantial and continuing impact on some carriers. But the final blow was a nearly 100-percent increase in the cost of fuel.

Despite all these adversities, traffic grew almost 12 percent, and consumers saved several billion dollars. But the industry's profit plummeted to only a few hundred million dollars. Worse, the long-term prognosis was bad.

The real spoiler has been the price of rule. In 1979 fuel for the industry rose from approximately 16 percent to 30 percent of total operating costs. Today that figure stands at about 34 percent.

These sharply rising costs have already forced the carriers to raise prices and reduce the availability of discount fares. Rising fares plus a recession economy have severely affected the industry.

The trunks in the first quarter posted net losses of a staggering $250.5 million while the locals lost $19.4 million. While first quarter losses are a common phenomenon in this industry, they come on the heels of heavy losses in the fourth quarter and precede what appears to be a substantial drop in traffic for the current year.

This situation caused the Board as early as January to begin rethinking the domestic fare situation and to issue a notice of proposed rulemaking on April 3, 1980.

We tentatively concluded that, for a variety of reasons, the SIFL formula, which was based on the DPFI cost curve developed in 1974, was far out of line with the current economics of the industry.

And, that to effectively require carriers to price their product at or near the DPFI levels was distorting the allocation of resources within the industry, was impairing service to small communities and could prevent carriers from achieving a reasonable return on investment which they might otherwise achieve even in a highly competitive market.

The SIFL is based upon a fare formula developed in phase 9 of the Board's domestic passenger fare investigation which was completed in March 1974 and was, in turn, derived from pre-1974 data.

Even at that time, the cost curve reflected average industry costs and not actual operating costs in all markets.

Mr. Chairman, as you can see from attachment A, in markets under 500 miles, the Board's fare formula generated a growing gap between costs and permissible fares.

I also, have, Mr. Chairman, a blown-up version of the first thousand miles. Because of the chart that is attached here, it's a little difficult to read, because it goes up to 1,000 miles.

I have here, which we will submit—I will finish the paragraph that discusses this, and I will go over this exhibit now.

As you can see from attachment A on the chart that was just handed to you, Mr. Chairman and Senator, that in markets under 500 miles, the Board's fare formula generated a growing gap between costs and permissible fares. Because of this discrepancy, local service carriers, which then served short-haul routes, were allowed to price up to 130 percent of the DPFI level.

The Board continued this policy under PS-80, so that until the Board's action last week, the local service carriers were free to price significantly higher than the trunks, regardless of route length.

Let me take a moment, Mr. Chairman, and just explain the chart that was just handed to you.

This shows the cost curve for the 727-100 domestic trunk air——

The CHAIRMAN. Would that be different from a DC-9 or some other aircraft that's used in those markets?

Mr. COHEN. Yes, Mr. Chairman. Each airplane has a different cost curve.

This shows, for the year ending September 30, 1979, the great gap between the actual cost of operating that airplane and the fares which are permitted under the civil system.

And in many instances, for short hauls, that gap is much more than 30 percent. You can see at 100 miles, it's almost 100-percent gap.

The CHAIRMAN. Now, you show this in a 727-100, and the short mileage. How many of the 727-100's are used in under 200 markets? You don't have to give me a definite figure. The point is there are not many.

Mr. COHEN. That's true.

We would be happy to put together the same figures for the DC-9. That is more commonly used than the 737.

The CHAIRMAN. I think it would be helpful if you have a chart showing the airplanes that are basically used in those markets, rather than one that is not very significantly used in the markets.

Mr. COHEN. I think it's used a lot on the shuttle between New York and Washington, for instance, and New York and Boston; in the heavy shuttle markets, I think it's used. But I agree that——

The CHAIRMAN. The shuttle between New York and Washington travels about 250 miles so the gap is much narrower.

Mr. COHEN. Aside from this fundmental problem with the formula, Mr. Chairman, there is, in the short hauls, under 400 miles, we found—I think you will find, as we submit for various airplanes, that the fare set by the SIFL are below the actual cost of operation, and that's the key problem with the system that existed before last week.

Aside from this fundamental problem with the formula, the dramatic change in the industry and the economy—which neither Congress nor the Board could have anticipated in 1978 when the act was being written—has further skewed the relationship of costs to permissible fare levels.

The three major adverse changes are:

One, the equipment mix which made up the DPFI cost curve has changed significantly. The capacity calculation included prop and prop jets and virtually no wide bodies. This affects all the cost relationships with the greatest distortion occurring in under 400-mile markets, where prop equipment used to predominate.

Two, the cost of capital was assumed to be 6.2 percent for debt and 16.75 percent for equity for a combined return of 12 percent. With interest rates ranging between 15 and 20 percent, when this testimony was drafted a couple of days ago, this is clearly too low.

Three, the assumed 45/55 debt-equity ratios are no longer applicable. Other changes, such as seat density and load factor increases may have helped the industry.

But now even load factors have substantially declined for many carriers. In essence, many of the key assumptions upon which the DPFI—now SIFL—was based upon no longer bear any relevance to the cost structure of the industry. But the problem goes even deeper.

In 1974 the industry was rather homogenous within each carrier class. There was a real distinction between trunks and locals. Today, after almost 2 years of deregulation, the distinction between classes has blurred and within each class the cost structure for individual carriers is highly varied.

For example, in its comments on the proposed rule, Braniff states that while the Board has projected industry costs to rise 13.8 percent during the first 6 months of 1980, it anticipates its own costs to rise 21.4 percent.

Braniff also notes that 61 percent of its nonstop schedules consist of markets under 500 miles and that in 14 of 21 new markets it competes with local service carriers or commuters which were not subject to the same fare ceiling.[4]

In 1978 and early 1979 when costs were relatively stable, the economy was booming and the carriers could increase productivity by adding capacity and increasing aircraft utilization, the problems with the DPFI were of no consequence. Today in a totally different environment holding carriers near to the SIFL could seriously harm the industry and be catastrophic for particular carriers.

During the debate on deregulation, Dr. Kahn and other proponents stated quite bluntly that a number of carriers might not survive under deregulation and would disappear either through merger, voluntary liquidation, or bankruptcy.

These possibilities are recognized and acceptable risks of doing business in a competitive market. An unacceptable risk would be for a carrier to be forced out of business, not as a result of competition, but because of Federal economic regulatory policy.

At a time when market entry is virtually unrestricted, it would be an unfortunate irony if imperfect and shortsighted economic regulation rather than legitimate market forces dictated corporate survival.

Faced with this rather stark reality, the question for the Board was not whether to create an upward zone of fare flexibility but rather how wide the zone should be and how it should be designed.

At our sunshine meeting last Tuesday, following the submission of comments on our proposed rule which I am submitting with this testimony, we discussed a variety of approaches ranging from 30-percent across the board—to the total upward flexibility advocated by most of the industry. After an hour and a half of intense debate, we settled on the principal scheme initially proposed in our notice back in April of unlimited upward flexibility for markets up to 200 miles; a 50-percent zone from 201 to 400 miles and a 30-percent zone for all other markets. Alaska, Hawaii, and Puerto Rico were excluded from our decision.

In the course of our discussion the fundamental criteria that emerged was that whatever we did, the zone had to be significantly above the standard industry fare levels. There are two reasons why this is so. First, we know from experience that with minor exceptions, every time the Board adjusted the SIFL, the carriers would raise their coach fares to that level.

If we merely created a 10- or 15-percent zone, the industry would most likely continue to take this as an upward price leader and just go to that level in a lockstep movement.

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[4] Comments of Braniff Airways, Incorporated in PSDR-66, Docket 37982 filed May 7, 1980.

In essence, we believe the industry is sufficiently competitive that removing the Board as the industry cartel pricing agent by setting a high zone will benefit consumers by forcing carriers to decide what fare level and structure is acceptable to the public rather than taking increases announced by the Board.

Second, we want to give the industry sufficient scope to develop new pricing strategies consistent with a deregulated environment. We believe a broad band of flexibility is necessary for individual carriers to really use pricing as a marketing tool.

We had indicated a willingness earlier to consider major fare revisions ad hoc. But the approach requires management to spread its marketing scheme before the entire industry for weeks or months awaiting Board action. Other carriers then have time to match or undercut the proposal. Such possibilities create strong disincentives to significantly depart from current practices without a nonsuspend zone.

While a 30-percent zone is probably sufficiently high to enable this development in longer-haul markets, it would not be sufficient in markets under 400 miles because of the defects with the DPFI. Almost 70 percent of single carrier markets served by certificated airlines under 200 miles as of January 1, 1980, were at least 19 percent above the SIFL already and 50 percent were between 25 and 35 percent above the SIFL.

Our Office of Economic Analysis estimates that the average fare in markets of 400 miles or less is 20 percent above the SIFL illustrated on attachment B.

Thus, it appears that the possible solution of merely extending to the trunks the 30-percent zone available to local service carriers will not give these carriers sufficient upward flexibility to develop new pricing schemes or to make their entry into short-haul markets attractive.

In addition, since the locals are now losing money, it is far from certain that the 30-percent ceiling which they now have is in fact above costs in short-haul markets. And we believe that the trunks costs in short hauls are generally higher than the locals.

Another problem with giving all carriers 20 or 30 percent over what they now have is that it could lead to very inefficient results in a number of markets; that is, if we add 20 or 30 percent to what exists now, which would then raise the locals to either 150 or 160 and raise the trunks to 130.

While such a system would virtually deregulate fares for local service carriers by creating a 50- or 60-percent zone, trunks would be subject to a limiting 20 or 30 percent ceiling. Under this approach, a local might raise its fare in a market to 150 percent of SIFL and a trunk which might want to serve the market for 10 percent less could not offer that fare.

This problem could be overcome by a matching provision. But, even matching could not help where a trunk operated a route under 400 miles and needed additional flexibility to develop a remunerative pricing strategy.

Aside from our desire to place the burden of pricing more directly on airline management, we were concerned that our pricing not force jet operators out of shorter haul markets because they are

uneconomic without giving them the opportunity to see if the community is willing to utilize the service at a higher fare.

To some extent the limited fare ceiling may have already caused some operators to leave markets they might otherwise have retained.

For example, in early 1979 many intra-California routes came under Federal jurisdiction for the first time. Fares in those markets had been held at low levels by the State public utilities commission.

When Hughes Airwest filed with the Board to raise fares to the SIFL level, we suspended the fares and issued a rule to phase in higher fares in California despite the carrier's objection that the fares were woefully uneconomic.

Our decision to help the consumer was followed by a major exodus by certificated carriers from many short-haul California markets. It may be that these carriers would have left anyway, but we do not know that nor do we know if they would have left as quickly.

Thus, when United left the Bakersfield-San Francisco market even the much lower cost commuter replacement had to raise the fare $11. Given a choice, communities may prefer a less expensive commuter service in these markets but again, that decision can and should be made by consumers in the marketplace.

It should not be the inevitable outcome of a Federal regulatory policy that effectively dictates the type of service received in any given market.

What is terribly relevant here is that the rise in jet fuel prices disproportionately affects short-haul service. Carriers and new entrants, particularly those serving small airports have to resort frequently to high cost spot fuel. And short-haul flights consume a disproportionate amount of fuel during takeoff and landing. By permitting greater flexibility in the short-haul markets, we recognize the unpleasant but no less real facts of life. We do not help small communities retain quality air service by requiring carriers to serve them well below cost.

In reaching our decision, Mr. Chairman, we wanted to be particularly careful that we did not subject any group of communities to an unreasonable possibility of bearing a greater fare burden than any other communities. By this I do not mean that communities should be served below cost. This was rarely the case under regulation and is totally inconsistent with a deregulated environment.

What I do mean, however, is that shorter haul markets should not be used to subsidize longer haul markets. We would not have eliminated the ceiling in markets under 200 miles if it appeared that there was even a reasonable possibility that essential air service communities or other small communities would cross subsidize the air service of larger, more competitive markets.

As you can see on attachment C, short-haul markets are today predominantly served by commuters. Indeed, almost 40 percent of the traffic in markets under 199 miles travels on commuter airlines. And these figures are somewhat misleading on the certificated side because they include in the certificated column all the former commuters using small aircraft that have been certificated

such as Air Midwest, Cochise, Altair, Air Wisconsin and Air New England and many others.

Commuter air fares have never been regulated by the Board. Since commuter fares are set totally in the marketplace, we looked at a large sample to see if they were significantly above local service carrier fares and found that they were not.

If you will look at attachment D, you will see that in a random sample of 187 monopoly commuter markets under 350 miles, 41.1 percent were either equal to or below the SIFL. Another 23 percent were between 0 and 14.9 percent above the SIFL and 11.8 were 30 percent or more above SIFL.

The specific markets which include a number of essential air service markets used in this sample are listed in attachment E. We also looked at a small sample of markets operated by some of the recently certificated commuters and found a similar distribution.

If you will turn now to attachment F, Mr. Chairman, you can see in the first column a summary of the fare level in all single-carrier markets for certificated carriers under 200 miles. The average fare level appears to be significantly higher than for commuters reflecting the fact that certificated costs are generally higher.

But as you can see, despite the facts that locals can price up to 30 percent and sometimes more above the SIFL, a substantial majority of the fares are less than 30 percent above the SIFL level.

We believe that these fares are not at the ceiling, because the under 200 mile markets are extremely competitive. Lower cost commuters are a real competitive threat in their short haul markets. But the pricing competition in these markets is also the automobile, bus, and to a lesser extent, the train.

Attachment G shows that for a trip up to almost 150 miles it is less expensive to drive than to fly. And, if there is more than one person traveling, ground travel becomes very competitive even in higher mileage blocks. These observations are similar to the results of a study by Boeing Aircraft, which concludes that the greatest potential for growth in air transportation is in markets over 200 miles where the airplane becomes price competitive with the automobile. Thus we feel confident that our decision to lift the fare ceiling in the shortest markets will not lead to excessive fares.

In the 201- to 400-mileage block, we have allowed 50 percent upward flexibility to trunks and locals. In this range the DPFI/SIFL cost curve is still very distorting. On the one hand we did not believe a 30-percent zone would give sufficient flexibility to cover costs and develop more innovative pricing schemes. On the other hand, while these markets have a great potential for intercarrier competition, they are not as subject to intermodal competition. We feel that the 50 percent will adequately meet the needs of the industry without creating unnecessary risks for the public.

In markets over 400 miles we established a 30-percent upward zone. If you will turn to attachment A again, you can see that in these longer haul markets the cost curve is below the fare curve so that an additional 30-percent zone appears to give carriers ample flexibility, even considering the needs of high cost carriers. In this mileage bracket we find some very competitive markets in which no upward limit is necessary.

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But there are 422 segments over 400 miles that enplane fewer than 100 passengers a day. These long haul thin routes are predominantly trunk carrier markets and the least likely to attract new competition. If any market were to be subject to abuse, it would be these rather, than the highly competitive shorter haul markets. See attachment H for more information on this matter.

We anticipate that fares in markets of all stage lengths will continue to rise as costs escalate. But, we also think that this is a good time to loosen up fare regulation. Current economic conditions will prevent carriers from substantially raising all fares. Traffic growth since mid-December has been virtually flat with many carriers reporting decreases compared to a year ago.

Moreover, there is clearly a point where higher fares will begin to drive down traffic. We know that traffic growth for the trunks has varied inversely with increasing yields. Attachment I shows that when yields rose over about 20 percent, traffic declined considerably.

I might just turn to that for a moment and point out, Mr. Chairman, that the yield for American Airlines in March 1980 versus March 1979—and that means about the average of its fares—rose 47.1 percent. That was the highest increase, and that was well before we did anything with the SIFL, with the flight fare flexibility. But their yield, their mix of coach and discount, and first count, which makes up the yield, went up 47.1 percent.

It's interesting, then, that that traffic dropped more than any other carrier's. Their traffic dropped 20 percent that month, compared to the previous month. And this was before United's strike, so there is no distortion here from United's strike yet, as there will be in April. Then United had the next highest yield increase and then next greatest traffic loss. And then Continental, the same. It shows here that when the—it's rather uncanny how generally they track each other—but when the yield increase was in the range of 20 percent, as it was for Braniff, Northwest, and Eastern, they actually saw increases in their traffic.

I think that the carriers have noticed this, and we think that they will pay attention to it in their pricing, because it doesn't do much good to charge everybody high prices and fly empty airplanes.

The industry must recognize that merely increasing fares cannot possibly solve their financial problems. But, if the industry, as opposed to individual carriers, is going to remain viable, it must have sufficient earnings to attract both debt and equity financing to support the acquisition of new energy-efficient equipment. Even with fare flexibility, some carriers may not survive. But this will be because the market found another carrier that can provide the service for less.

We intend to monitor the effects of our decisions in particular markets carefully. We have directed the staff to bring to our attention any proposed dramatic increase in markets subject to airport slot constraints and involving service to isolated small communities. And we have specifically reserved the right to impose a lower ceiling if it appeared that consumers in monopoly markets are being gouged.

What we have done, Mr. Chairman, does create some risks. Giving carriers the freedom that they need to develop comprehensive fare policies that reflect current market conditions of necessity carries with it the possibility for abuse. These, however, are no different from the risks that exist in the private sector generally. Moreover, we believe any risks of consumer abuse are minimal and that we have the staff resources to spot real abuse and do something.

Our action also serves as an important transitional step to the total fare deregulation which Congress has set for December 31, 1982. Between now and then we can either pull the reins in or let them go, depending on the competitiveness of the industry and the potential benefits to the public.

Mr. Chairman, deregulation is a two-way street. The public has already saved huge sums of money and continues to save as low fare services expand, even in the recession, to more markets. Let us now give the industry a chance. If we err on the high side, we impose a slight burden on each individual who chooses to fly. If we err on the low side, we severely cripple the industry, stifle its growth, reduce competition, and reduce the consumer benefits that will otherwise continue to flow from deregulation.

Mr. Chairman, I thank you for your concern and your indulgence in allowing me to read this lengthy statement. I hold myself, Ms. Bailey, and a significant portion of my staff open to answer your questions and those of Senator Kassebaum.

[The attachments follow:]

ATTACHMENT A

Attachment B

Local Carrier Fares: The Effects of Fare Flexibility

Local service carriers have a greater degree of fare flexibility than the trunks. To consider the possible effects of giving trunk carriers increased fare flexibility we analyzed the effects of competition and costs in the establishment of local service carrier fares. The study supports a conclusion that potential competition is an effective force in the establishment of fares and consequently local service carrier fares tend to reflect costs.

We selected a sample of 43 markets served by local service carriers. These markets ranged from 85 miles to 778 miles. For each market we compared the local carrier's fare in the December 15, 1979 OAG with the SIFL fare at that time. Though local service carriers could charge up to 130 Percent of the SIFL fare, the average fare in these markets was only 12.5 percent above the SIFL fare.[1] In five markets (11.6 percent of the sample) the local carrier fares were at the ceiling, while in another six markets the carrier charged as much as 20 percent above the SIFL fare, a clear indication that factors other than CAB fare regulation are constraining local carrier fares.

Using a statistical technique known as regression analysis, we attempted to explain the local carrier's fare as a percentage of the SIFL fare. We expected that market distance would be important in explaining differences in local carrier fares, since it is well known that the SIFL fare formula sets fares in short-haul markets below costs. Thus, we expected that the greater the length of haul, the lower the local carriers' fares would be as a percent of the SIFL fare. Trunk fares are constrained by the Board to be no more than five per cent above the SIFL fare level in 2 and 3 carrier markets and ten percent in 4 carrier markets, therefore, the presence of a trunk carrier in a market should have a negative influence on local carrier fares. Finally, the effect on fares of the presence of another local carrier or a commuter carrier in a market should help settle the question of whether potential competition is as effective as actual competition in keeping fares close to cost.[2]

We found that the relationship between the local fare as a percentage of the SIFL fare and distance was as predicted. Additionally, the presence of a trunk carrier in markets below 400 miles did indeed have a strong negative effect on local carrier fares. However, neither local service carrier competition, commuter competition, nor, in those markets above 400 miles, trunk competition had a significant impact on local service fares.

Our estimates of local fares as a percentage of the SIFL fare, controlling for the existing competition, were as follows:

Estimated local fare as a percentage of the DPFI fare

Mileage block	
0 to 100	1.212
101 to 200	1.186
201 to 300	1.183
301 to 400	1.203
401 to 500	1.046
501 to 600	1.050
601 to 700	1.011
701 and over	0.988

Though the estimate of fares in the various mileage blocks differ, we are only able to distinguish statistically between fares in the mileage blocks above 400 miles and those below 400 miles. For example, we cannot say with any confidence that fares in 0–100 mile markets differ from fares in 201–300 mile markets. Similarly we cannot say that fares in markets less than 400 miles are significantly greater than fares in different mile blocks above 400 miles differ. However, we can say that fares in markets greater than 400 miles

The estimates above control for the existence of competition. In markets below 400 miles the presence of a trunk carrier meant fares were 15.9 percentage points lower than the estimates given above. The other competition variables—i.e., those indicating the presence of a commuter or other locals—did not have a significant effect on fares. Thus, for our sample, fares in monopoly markets were no more likely to be at the fare ceiling than were fares in markets served by commuters or other locals. This finding is consistent with the view that the threat of competition

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[1] Because of rounding, some fares were actually above the theoretical maximum.

[2] In those cases where there was more than one local service carrier, we used the fare of the carrier with the most departures.

is as effective as the presence of an actual competitor in holding fares in line with costs.

An additional interpretation of our estimates is that if trunk carriers were given increased fare flexibility, fares in trunk markets less than 400 miles would increase by 16 percent. However, a less disturbing alternative interpretation appears plausible. Many factors determine fares in a market. We have omitted all but a few. For example, the number of passengers in the market, the amount of connecting traffic at the end points of the market, and passenger demand for frequent service all should affect fares. In our analysis we included only distance and competition as factors to explain differences in fare levels. Our observation that trunk competition is important in restraining fare levels in less than 400 mile markets may be the result of excluding these other variables from our analysis. The passage of the Airline Deregulation Act gave carriers substantially increased flexibility to withdraw service from markets. This is especially true of markets where there are two or more carriers. In this sample, all markets have a local service carrier and therefore a trunk carrier has only to file a 401(j) notice to withdraw service. A trunk carrier would serve these markets only if the carrier could not use its equipment more profitably in another market. This suggests the alternative interpretation of our estimate of the effect on fares of the presence of a trunk competitor: Trunk carriers are serving most of these markets because they are earning profits at the Board imposed fare levels. This interpretation implies that if we were able to include all factors determining fares in markets, the existence of a trunk competitor would be much less important in explaining local service carrier fares. Therefore, relaxing Board fare regulations in these markets might not lead to significant fare increases. In those markets trunks have decided not to abandon, the local carrier and the trunk carrier are apparently covering their relevant costs, and competition should limit fare increases in these markets even in the absence of Board fare ceilings.

There is additional support for a conclusion that fares are cost-based. In markets above 400 miles, local carriers' coach fares are not significantly different from fares allowed under Board regulation of the trunks. Even though the locals are able to charge 130 percent above the SIFL, they do not. In the Domestic Passenger Fare Investigation, the Board set fares in markets less than 400 miles at below costs. The result that local service carriers' fares are substantially above SIFL levels only in markets below 400 miles thus provides striking support for the claim that trunk fare ceilings preclude profitable operation in many short-haul markets.

Attachment C

DISTRIBUTION OF TRAFFIC BY MILEAGE BLOCK YEAR ENDED JUNE 30, 1979

Mileage block	Passengers carried			Commuters' as % of total (percent)
	Total	Certificated	Commuters[1]	
0 to 49	1,713,383	68,730	1,644,653	96.0
50 to 99	5,017,121	1,144,440	3,873,681	77.2
100 to 149	7,295,076	4,752,220	2,542,856	34.9
150 to 199	10,190,852	8,673,020	1,517,832	14.9
200 to 249	11,397,362	10,752,650	644,712	5.6
250 to 299	8,780,994	8,505,980	275,104	3.1
300 and over	146,675,059	146,442,870	182,189	0.1

[1] Directions: 0 & 1
[2] Below 0 & 0

Attachment D

COMPARISON OF SIFL AND TARIFF FARES AS OF JAN. 1, 1980, COMMUTER CARRIERS AND NEW ENTRANTS, SELECTED NONSTOP MONOPOLY MARKETS, 0–350 MILES

Percent above or below SIFL	Number of markets	Percent distribution
35.0 plus	8	4.3
30.0 to 34.9	14	7.5
25.0 to 29.9	23	12.3

COMPARISON OF SIFL AND TARIFF FARES AS OF JAN. 1, 1980, COMMUTER CARRIERS AND NEW ENTRANTS, SELECTED NONSTOP MONOPOLY MARKETS, 0-350 MILES—Continued

Percent above or below SIFL	Number of markets	Percent distribution
20.0 to 24.9	13	7.0
15.0 to 19.9	9	4.8
10.0 to 14.9	20	10.7
5.0 to 9.9	14	7.5
0 to 4.9	9	4.8
Tariff = SIFL	10	5.3
-4.9 to 0	15	8.0
-9.9 to -5.0	13	7.0
-14.9 to -10.0	5	2.7
-19.9 to -15.0	3	1.6
-25.9 to -20.0	10	5.3
-29.9 to -25.0	5	2.7
-34.9 to -30.0	6	3.2
-35.0 plus	10	5.3
Total	187	100.0

ATTACHMENT E

COMPARISON OF SIFL AND TARIFF FARES AS OF JAN. 1, 1980, NEW ENTRANTS, SELECTED NONSTOP MONOPOLY MARKETS [1]

Market	Distance (miles)	Coach fare		Actual percent SIFL
		Actual	SIFL	
Allentown, Pa. to Philadelphia, Pa.	55	$37.04	$30.27	22.4
Utica, N.Y. to Boston, Mass.	229	62.86	52.42	20.1
Oxnard, Calif. to Los Angeles, Calif.	59	28.70	30.78	-6.8
San Diego, Calif. to Yuma, Ariz.	150	86.94	92.37	10.8
Dubuque, Iowa to Cedar Rapids, Iowa	63	37.04	51.29	18.4
Fresno, Calif. to Bakersfield, Calif.	100	35.19	36.00	-2.3
Philadelphia, Pa. to White Plains, N.Y.	107	48.15	36.89	30.5
Utica, N.Y. to New York, N.Y.	181	89.15	86.31	4.0
Orange County, Calif. to Los Angeles, Calif.	32	26.85	27.34	-1.8
Moline, Ill. to Milwaukee, Wis.	169	89.07	84.78	9.6
Los Angeles, Calif. to Bakersfield, Calif.	114	36.11	37.78	-4.4
Las Vegas, Nevada to Santa Barbara, Calif.	288	54.63	59.93	-8.8

[1] Carriers covered: Altair, Empire, Golden West, Imperial, Mississippi valley, Swift Aire, and Aspenair.

COMPARISON OF SIFL AND TARIFF FARES AS OF JAN. 1, 1980, COMMUTER CARRIERS, NONSTOP MONOPOLY MARKETS

Market	Distance (miles)	Fiscal 1979		Coach fare		Actual percent SIFL
		Passengers	RPMs	Actual	SIFL	
1-50 Miles						
Albuquerque, N. Mex. to Santa Fe, N. Mex.	49			$23.15	$29.63	-21.9
Allentown, Pa. to Reading, Pa.	34			9.26	27.78	-66.7
Aspen, Colo. to Crested Butte, Colo.	26			18.52	26.85	-31.0
Catalina Island, Calif. to Long Beach, Calif.	32			18.06	27.78	-35.0
Catalina Island, Calif. to San Pedro, Calif.	29			18.06	26.85	-32.7
Catalina Island, Calif. to Orange County, Calif.	37			22.22	27.78	-20.0
Baker, Oreg. to La Grande, Oreg.	33			32.41	27.78	16.7
Bangor, Maine to Bar Harbor, Maine	34			30.56	27.78	10.0
Bedford, Mass. to Boston, Mass.	16			20.37	25.00	-18.5

COMPARISON OF SIFL AND TARIFF FARES AS OF JAN. 1, 1980, COMMUTER CARRIERS, NONSTOP MONOPOLY MARKETS—Continued

Market	Distance (miles)	Fiscal 1979		Coach fare		Actual percent SIFL
		Passengers	RPM's	Actual	SIFL	
Bellingham, Wash. to Eastsound, Wash.	18			12.96	25.93	-50.0
Block Island, R.I. to Westerly, R.I.	17			11.11	25.00	-55.6
Bloomington, Ill. to Champaign, Ill.	46			27.78	28.70	-3.2
Blue Bell, Pa. to Philadelphia, Pa.	19			23.15	25.93	-10.7
Borrego Springs, Calif. to Palm Springs, Calif.	40			18.52	28.70	-35.5
Boston, Mass. to Nashua, N.H.	38			26.85	27.78	-3.3
Boston, Mass. to Provincetown, Mass.	45			23.15	28.70	-19.3
Bridgeport, Conn. to New Haven, Conn.	14			23.15	25.00	-7.4
Burlington, Vt. to Plattsburgh, N.Y.	23			23.15	25.93	-10.7
Cape Girardeau, Mo. to Carbondale, Ill.	42			27.78	28.70	-3.2
Cedar City, Utah to St. George, Utah	50			17.59	29.63	-40.6
Clarksburg, W. Va. to Morgantown, W. Va.	29			35.19	26.85	31.1
Cedar Lake City, Tex. to Houston, Tex.	32			27.78	27.78	0.0
Clinton, Iowa to Dubuque, Iowa	45			36.11	28.70	25.8
Columbia, S.C. to Sumter, S.C.	19			16.67	25.93	-35.7
Corvallis, Ore. to Eugene, Oreg.	26			29.63	26.85	10.4
Total		298,262	8,994,000			
51-100 Miles						
Alamogordo, N. Mex. to El Paso, Tex.	76			$33.33	33.33	0.0
Albany, N.Y. to Poughkeepsie, N.Y.	77			30.56	33.33	-8.3
Alburquerque, N. Mex. to Los Alamos, N. Mex.	61			21.00	31.48	-33.3
Alexandria, La. to Ft. Polk, La.	58			41.67	30.56	36.4
Alexandria, La. to Lafayette, La.	84			43.52	34.26	27.0
Alexandria, La. to Monroe, La.	78			42.52	33.33	30.6
Allentown, Pa. to Philadelphia, Pa.	55			37.96	30.56	24.2
Altoona, Pa. to Harrisburg, Pa.	83			38.89	34.26	13.5
Anderson, S.C. to Columbia, S.C.	99			23.15	36.11	-35.9
Atlantic City, N.J. to Newark, N.J.	93			38.89	35.19	10.5
Atlantic City, N.J. to Philadelphia, Pa.	55			38.89	30.56	27.3
Atlantic City, N.J. to Trenton, N.J.	66			33.33	31.48	5.9
Atlantic City, N.J. to Baltimore, Md.	61			35.19	31.48	11.8
Augusta, Maine to Bangor, Maine	59			30.56	30.55	0.0
Augusta, Maine to Bar Harbor, Maine	92			33.33	35.19	-5.3
Augusta, Maine to Portland, Maine	53			30.56	29.63	3.1
Baker, Oreg. to Pendelton, Oreg.	78			37.96	33.33	13.9
Bakersfield, Calif. to Fresno, Calif.	100			35.19	36.11	-2.6
Baltimore, Md. to Hagerstown, Md.	67			40.74	31.48	29.4
Baltimore, Md. to Salisbury, Md.	85			44.44	34.26	29.7
Battle Creek, Mich. to Detroit, Mich.	98			45.37	636.11	25.6
Battle Creek, Mich. to Elkhart, Ind.	56			35.19	030.55	15.2
Bellingham, Wash. to Seattle, Wash.	94			24.93	35.19	-29.2
Boise, Idaho to Ontario, Oreg.	51			34.26	29.63	15.6
Boise, Idaho to Sun Valley, Idaho	96			38.79	35.19	10.5
Boston, Mass. to Concord, N.H.	63			33.63	31.48	5.9
Boston, Mass. to New London, Conn.	89			25.93	34.26	-24.3
Boston, Mass. to Keene, N.H.	74			32.41	32.41	0.0
Boston, Mass. to Laconia, N.H.	86			34.26	34.26	0.0
Buffalo, N.Y. to Jamestown, N.Y.	61			39.81	131.48	26.5
Burlington, Iowa to Ottumwa, Iowa	73			40.74	32.41	25.7
Burlington, Vt. to Massena, N.Y.	89			32.41	34.26	-5.4
Burlington, Vt. to Saranac Lake, N.Y.	53			28.70	29.63	-3.1
Canon City, Colo. to Denver, Colo.	93			24.07	35.19	-31.6
Carbondale, Ill. to Paducah, Ky.	56			28.70	30.56	-6.1
Carbondale, Ill. to St. Louis, Mo.	90			42.59	5.19	1.0
Cedar Rapids, Iowa to Dubuque, Iowa	63			37.04	1.48	7.7
Charleston, S.C. to Hilton Head Island, S.C.	60			21.30	0.56	-30.3
Charleston, W. Va. to Clarksburg, W. Va.	97			44.44	35.19	26.3

COMPARISON OF SIFL AND TARIFF FARES AS OF JAN. 1, 1980, COMMUTER CARRIERS, NONSTOP MONOPOLY MARKETS—Continued

Market	Distance (miles)	Fiscal 1979		Coach fare		Actual percent SIFL
		Passengers	RPM's	Actual	SIFL	
Charleston, W. Va. to Elkins, W. Va.	100			37.96	36.11	5.1
Charleston, W. Va. to Parkersburg, W. Va.	68			40.74	31.48	29.4
Chicago, Ill. to Elkhart, Ind.	100			39.81	36.11	10.2
Chicago, Ill. to Sterling/Rock Falls, Ill.	93			38.89	35.19	10.5
Chicago, Ill. to Valparaiso, Ind.	59			23.15	30.56	-24.3
Chicago, Ill. to Waukesha, Wis.	75			37.04	32.41	14.3
Chico, Calif. to Redding, Calif.	54			27.78	30.56	-9.1
Chico, Calif. to Sacramento, Calif.	77			43.52	33.33	30.6
Clarksburg, W. Va. to Pittsburgh, Pa.	83			43.52	34.26	27.0
Cleveland, Ohio to Mansfield, Ohio	54			38.89	30.56	27.3
Clovis, N. M. to Lubbock, Tex.	89			26.85	34.26	-21.6
College Station, Tex. to Houston, Tex.	74			37.96	32.41	17.1
Columbia, S.C. to Greenville, S.C.	94			23.15	35.19	-34.2
Columbia, S.C. to Greenwood, S.C.	64			23.15	31.48	-26.5
Columbus, Nebr. to Hastings, Nebr.	81			40.74	33.33	22.2
Columbus, Nebr. to Omaha, Nebr.	76			39.81	32.41	22.8
Corvallis, Oreg. to Portland, Oreg.	83			34.26	34.26	0.0
Cumberland, Md. to Latrobe, Pa.	57			24.07	30.56	-21.2
Dallas/Ft. Worth, Texas to Waco, Tex.	89			45.37	34.26	32.4
Allentown, Pa. to Philadelphia, Pa.	55			37.96	30.56	24.2
Borrego Springs, Calif. to San Diego, Calif.	62			23.15	31.48	-26.5
Total		50,896	3,983,000			
101-150 Miles						
Akron/Canton, Ohio to Detroit, Mich.	134			54.63	40.74	34.1
Albany, N.Y. to Binghamton, N.Y.	117			34.26	37.96	-9.7
Albany, N.Y. to Providence, R.I.	141			45.37	41.67	8.9
Albany, N.Y. to Saranac Lake, N.Y.	115			36.11	37.96	-4.9
Albany, N.Y. to Syracuse, N.Y.	119			33.33	37.96	-12.2
Albany, N.Y. to White Plains, N.Y.	116			64.81	32.96	96.6
Alexandria, La. to Shreveport, La.	116			39.81	37.96	4.9
Alexandria, Minn. to Minneapolis/St. Paul, Minn.	126			33.33	38.89	-14.3
Allentown, Pa. to Binghamton, N.Y.	110			37.04	37.04	0.0
Altoona, Pa. to Pittsburgh, Pa.	102			47.22	36.11	30.8
Baltimore, Md. to Cumberland, Md.	116			36.11	37.96	-4.9
Baltimore, Md. to Newport News, Va.	141			53.70	41.67	28.9
Baltimore, Md. to Ocean City, Md.	103			129.63	36.11	259.0
Bangor, Maine to Presque Isle, Maine	135			42.59	40.74	4.5
Battle Creek, Mich. to Chicago, Ill.	138			46.30	40.74	13.6
Beaufort, S.C. to Columbia, S.C.	103			29.63	36.11	-17.9
Binghamton, N.Y. to Buffalo, N.Y.	150			41.67	42.59	-2.2
Binghamton, N.Y. to Poughkeepsie, N.Y.	115			60.19	37.96	58.6
Boston, Mass. to Bridgeport, Conn.	137			30.56	40.74	-25.0
Boston, Mass. to New Haven, Conn.	123			30.56	38.89	-21.4
Boston, Mass. to Rutland, Vt.	127			38.89	38.89	0.0
Boston, Mass. to Springfield, Vt.	102			35.19	36.11	-2.5
Bradford, Pa. to Pittsburgh, Pa.	123			50.00	38.89	28.6
Tri-City Airport, Tenn. to Charlotte, N.C.	120			50.00	38.89	28.6
Tri-City Airport, Tenn. to Greensboro/High Point, N.C.	140			50.00	40.74	22.7
Brownwood, Tex. to Dallas/Ft. Worth, Tex.	136			50.93	40.74	25.0
Butte, Mont. to Missoula, Mont.	101			45.37	36.11	25.6
Cape Girardeau, Mo. to St. Louis, Mo.	114			47.22	37.96	24.4
Carbondale, Ill. to Springfield, Ill.	144			33.33	41.67	-20.0
Cedar City, Utah to Page, Ariz.	105			29.63	37.04	-20.0
Cedar Rapids/Iowa City, Iowa to La Crosse, Wis.	139			62.96	40.74	54.5
Charleston, W. Va. to Montgomery, Ala.	126			47.22	38.89	21.4
Chattanooga, Tenn. to Nashville, Tenn.	112			36.11	37.96	-4.9

COMPARISON OF SIFL AND TARIFF FARES AS OF JAN. 1, 1980, COMMUTER CARRIERS, NONSTOP MONOPOLY MARKETS—Continued

Market	Distance (miles)	Fiscal 1979		Coach fare		Actual percent SIFL
		Passengers	RPM's	Actual	SIFL	
Chicago, Ill. to Clinton, Iowa	125			40.74	38.89	4.8
Chicago, Ill. to Lafayette, Ind.	119			41.67	37.96	9.8
Chicago, Ill. to Sheboygan, Wis.	126			50.00	38.89	28.6
Clemson, S.C. to Columbia, S.C.	114			23.15	37.96	-39.0
Columbia, S.C. to Hilton Head Island, S.C.	121			29.63	38.89	-23.8
Columbia, S.C. to Pickens, S.C.	109			23.15	37.04	-37.5
Craig, Colo. to Denver, Colo.	149			57.44	42.59	34.9
Crested Butte, Colo. to Denver, Colo.	126			41.67	38.89	7.1
Cumberland, Md. to Washington, D.C.	107			38.89	37.04	5.0
Dallas/Ft. Worth, Tex. to Killeen, Tex.	130			51.85	39.81	30.2
Dallas/Ft. Worth, Tex. to Paris, Tex.	105			46.30	37.04	25.0
Dallas/Ft. Worth, Tex. to Temple, Tex.	122			50.00	38.89	28.6
Dallas/Ft. Worth, Tex. to Tyler, Tex.	102			47.22	36.11	30.8
Total		448,243	54,089,000			
151–200 Miles						
Abilene, Tex. to Austin Tex.	187			$49.07	$47.22	3.9
Alamogordo, N. Mex. to Albuquerque, N. Mex.	156			50.00	43.52	14.9
Albuquerque, N. Mex. to Las Cruces, N. Mex.	191			50.00	47.22	5.9
Albuquerque, N. Mex. to Silver City, N. Mex.	188			50.00	47.22	5.9
Alexandria, La. to New Orleans, La.	156			44.44	43.52	2.1
Appleton, Wis. to Chicago, Ill.	160			50.00	43.52	14.9
Eureka/Arcata, Calif. to Santa Rosa, Calif.	184			69.44	46.30	50.0
Asbury Park, N.J. to Washington, D.C.	183			50.93	46.30	10.0
Austin, Tex. to San Angelo, Tex.	182			60.19	46.30	30.0
Baltimore, Md. to Lynchburg, Va.	188			59.26	47.22	25.5
Beckley, W. Va. to Pittsburgh, Pa.	193			50.93	48.15	5.8
Beverly, Mass. to New York, N.Y.	197			35.00	48.15	-27.3
Blythe, Calif. to Phoenix, Ariz.	157			54.63	43.52	25.5
Boston, Mass. to Farmingdale, N.Y.	168			41.6.	44.44	-6.2
Boston, Mass. to Poughkeepsie, N.Y.	157			49.07	43.52	12.8
Boston, Mass. to Rockland, Me.	151			41.67	42.59	-2.2
Boston, Mass. to White Plains, N.Y.	166			49.07	44.44	10.4
Camden, Ark. to Memphis, Tenn.	187			52.78	47.22	11.8
Chicago, Ill. to Macomb, Ill.	176			47.22	45.37	4.1
Chicago, Ill. to Wisconsin Rapids, Wis.	191			57.41	47.22	21.6
Chico, Calif. to San Francisco, Calif.	153			48.15	42.59	13.1
College Station, Tex. to Dallas/Ft. Worth, Tex.	164			53.70	44.44	20.8
Dallas/Ft. Worth, Tex. to Nacogdoches/Lufkin, Tex.	164			44.44	44.44	0.0
Dallas/Ft. Worth, Tex. to Texarkana, Ark.	180			60.19	46.30	30.0
Total		263,985	44,678,000			
201–250 Miles						
Akron/Canton, Ohio to Cincinnati, Ohio	214			$60.19	$50.93	18.2
Appleton, Wis. to Minneapolis/St. Paul, Minn.	236			61.11	53.70	13.8
Eureka/Arcata, Calif. to Sacramento, Calif.	206			45.37	49.07	-7.5
Atlanta, Ga. to St. Simons Island, Ga.	247			53.70	54.63	-1.7
Baltimore, Md. to Roanoke, Va.	220			64.81	50.93	27.3
Bluefield, W. Va. to Pittsburgh, Pa.	227			56.48	51.85	8.9
Boston, Mass. to Utica, N.Y.	229			64.81	52.78	22.8
Burlington, Vt. to White Plains, N.Y.	237			57.41	53.70	6.9
Cadillac, Mich. to Chicago, Ill.	202			51.85	49.07	5.7
Cedar City, Utah to Salt Lake City, Utah	221			47.22	51.85	-8.9

COMPARISON OF SIFL AND TARIFF FARES AS OF JAN. 1, 1980, COMMUTER CARRIERS, NONSTOP MONOPOLY MARKETS—Continued

Market	Distance (miles)	Fiscal 1979		Coach fare		Actual percent SIFL
		Passengers	RPM's	Actual	SIFL	
Cedar Rapids/Iowa City, Iowa to Omaha, Nebr	221			56.68	51.85	8.9
Charlotte, N.C. to Chattanooga, Tenn	242			62.96	53.70	17.2
Charlotte, N.C. to Hilton Head Island, N.C.	207			51.85	50.00	3.7
Cincinnati, Ohio to Nashville, Tenn	230			75.93	52.78	43.9
Dallas/Ft. Worth, Tx. to El Dorado, Ark	248			64.81	54.63	18.6
Total		90,391	21,175,000			
251–300 Miles						
Binghamton, N.Y. to Boston, Mass	255			$73.15	$55.56	31.7
Boise, Idaho to Missoula, Mont	254			78.70	55.56	41.6
Dallas/Ft. Worth, Tex. to Hot Springs, Ark	252			72.22	55.56	30.0
Total		27,875	7,071,000			
301–350 Miles						
Abilene, Tex. to Houston, Tex	323			$58.33	$64.81	-10.0
Boston, Mass. to Presque Isle, Maine	332			65.74	65.74	0.0
Total		19,941	6,504,000			

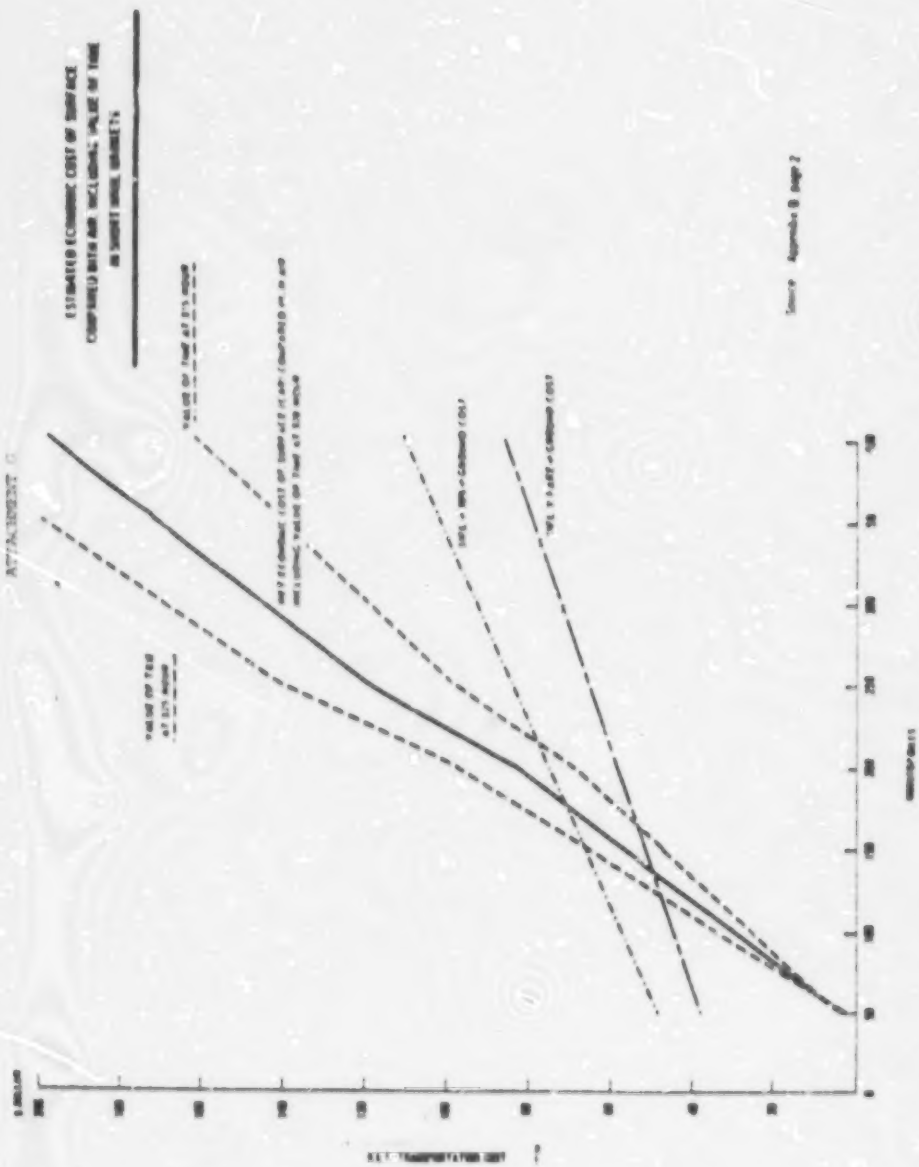
ATTACHMENT F

COMPARISON OF SIFL AND TARIFF FARES JAN. 1, 1980 DOMESTIC TRUNK AND LOCAL SERVICE, NONSTOP MONOPOLY MARKETS

Percent tariff above (–) or below (+) SIFL	0-200 Miles		201-400 Miles		401-600 Miles		601 Plus miles		All markets	
	Number of markets	Percent of distribution	Number of markets	Percent of distribution	Number of markets	Percent of distribution	Number of markets	Percent of distribution	Number of markets	Percent of distribution
–35.0 plus	2	0.5	4	1.3					6	0.5
–34.9 to –30.0	87	20.4	20	6.6					107	9.2
–29.9 to –25.0	124	29.0	49	16.2	1	0.8	1	0.03	175	15.0
–24.9 to –20.0	27	6.3	22	7.3	2	1.4	3	1.0	54	4.6
–19.9 to –15.0	58	13.6	31	10.3	3	2.2	6	2.0	98	8.4
–14.9 to –10.0	13	3.0	17	5.6	5	3.6	41	13.7	76	6.5
–9.9 to –5.0	26	6.1	51	16.9	15	10.9	134	44.7	226	19.4
–4.9 to 0	28	6.6	50	16.6	71	51.4	25	8.3	174	14.9
Tariff = SIFL	45	10.5	49	16.2	37	26.8	61	26.3	192	16.4
0.0 to 4.9	2	0.5	6	2.0	4	2.9	21	7.0	33	2.8
5.0 to 9.9			3	1.0					3	0.3
10.0 to 14.9							1	0.03	1	0.1
15.0 to 19.9										
20.0 to 24.9	15	3.5							15	1.3
25.0 to 29.9							1	0.03	1	0.1
30.0 to 34.9							6	2.0	6	0.5
35.0 plus										
Total	427	100.0	302	100.0	138	100.0	300	100.0	1,167	100.0

Source: Computer run of Domestic Fares for all monopoly markets.

ATTACHMENT G



ESTIMATED ECONOMIC COST OF SURFACE COMPARED WITH AIR INCLUDING VALUE OF TIME AT $20 PER HOUR IN SHORT-HAUL MARKETS

Trip miles		Total travel time by air [1]	Travel time by auto [2]	Time saved by air	Surface travel cost			Air fare [3]	Ratio total service cost to air
Air	Surface [1]				Cash expense [4]	Value of time [5]	Total		
50	55	1:15	1:06	(0:09)	$6.60	($3.00)	$3.60	$38.00	0.09
100	110	1:22	2:12	:50	13.20	16.67	29.87	45.00	.66
150	165	1:28	3:18	1:50	19.80	36.67	56.47	52.00	1.09
200	220	1:35	4:24	2:49	26.40	56.33	82.73	59.00	1.40
250	275	1:42	[7] 6:00	4:18	33.00	86.00	119.00	66.00	1.80
300	330	1:48	[7] 7:06	5:18	39.60	106.00	145.60	72.00	2.02
350	385	1:55	[7] 8:12	6:17	46.20	125.67	171.87	79.00	2.18
400	440	2:01	[7] 9:18	7:17	52.80	145.67	198.47	86.00	2.31

[1] Estimated at a circuity factor of 10 percent of nonstop air miles.
[2] Computed using industry average block time for DC-9 plus 7 hours for ground time.
[3] Computed at 50 miles per hour.
[4] Estimated at 12 cents per mile.
[5] Estimated at $20 per hour based on an assumed annual income level to $40,000 and 2,000 hours.
[6] Split fare as of Jan. 1, 1980 plus $6 for surface travel applied to air trip miles.
[7] 0:30 additional elapsed time added for trips in excess of 220 surface miles.

Note.—This does not include any estimate of total opportunity costs. Because of the advantage of the automobile over scheduled air service in terms of schedule delay (both frequency and stochastic delay), the study understates the advantage of the automobile.

ATTACHMENT H

SEGMENTS AND PASSENGERS CARRIED BY MILEAGE BLOCK AND DENSITY, FEBRUARY 1980, CERTIFICATED CARRIERS

Density (passengers per segment per day)	0-200		201-400		401 plus	
	Number of segments	Passengers	Number of segments	Passengers	Number of segments	Passengers
0 to 100	440	394,020	222	171,738	422	238,769
101 to 200	104	412,227	73	289,723	161	661,764
201 to 300	58	369,081	37	252,600	77	532,134
301 to 400	40	386,753	29	252,454	63	614,227
401 to 500	22	273,750	15	190,845	36	451,079
501 to 600	17	261,448	18	275,484	33	503,853
601 to 700	8	144,550	9	163,844	33	594,193
701 to 800	4	85,304	9	190,704	21	439,135
801 to 900	5	115,222	5	117,769	12	286,624
901 to 1,000	5	131,042	3	79,164	17	457,911
1,001 to 1,500	14	476,058	19	507,689	43	1,501,552
1,501 to 2,000	5	247,253	12	582,405	22	1,022,215
2,001 to 2,500	1	56,563	3	180,099	19	1,208,333
2,501 to 3,000	2	145,352	2	150,159	11	841,237
3,001 plus	1	123,060	7	718,388	6	617,870
Total	726	3,621,683	456	4,107,065	976	9,968,896

ATTACHMENT I

MARCH 1980

(In percent)

	Yield	Traffic
American Airlines	47.1	20.6
United Airlines	43.7	15.6
Continental Airlines	36.7	13.7

MARCH 1980—Continued

(In percent)

	Yield	Traffic
Trans World Airlines	31.0	-1.0
Western Airlines	29.4	-12.7
Braniff International	20.7	+2.4
Northwest Orient	20.5	+5.6
Eastern Airlines	18.9	+5.7

[Civil Aeronautics Board, Washington, D.C.—Policy Statements, Amendment No. 71 to Part 399, Docket 37982]

Part 399—Statements of General Policy (Domestic Passenger Fare Flexibility)

Agency: Civil Aeronautics Board.
Action: Interim policy statement.
Summary: The CAB broadens the zones within which airlines may set domestic passenger fares with limited risk of suspension by the agency. This interim policy includes full downward flexibility in all markets, and full upward flexibility for flights up to 200 miles. For flights between 200 and 400 miles, airlines may set fares up to 50 percent above the standard industry fare level, and for flights over 400 miles, 30 percent above. This policy is designed to counteract a bias against short-haul markets that is built into the previous zone of fare flexibility and to ease the transition to the full pricing-deregulation that is mandated by the Airline Deregulation Act. Member Schaffer dissents and would allow additional flexibility only on an across-the-board basis rather than on a system which differentiates among markets on the basis of distance.
Dates: The policy was put into effect May 14, 1980. The amendments of 14 CFR Part 399 are effective June 11, 1980.
For further information contact: Mark Schwimmer, Office of the General Counsel, 202-673-5442, or Julien R. Schrenk, Chief, Domestic Fares and Rates Division, Bureau of Domestic Aviation, Civil Aeronautics Board, 1825 Connecticut Avenue, N.W., Washington, D.C. 20428; 202-673-5208.

SUPPLEMENTARY INFORMATION

Introduction

In a recent notice of proposed rulemaking, the Civil Aeronautics Board invited comments on six options to make domestic passenger fare policies more flexible (PSDR-66; 45 FR 24178; April 9, 1980) (the NPRM).

After considering the comments the Board decided, at its May 13, 1980, public meeting, to adopt the following combination of the proposed options as an interim policy: full downward flexibility in all markets; full upward flexibility for flights up to 200 miles; 50 percent upward flexibility for flights between 200 and 400 miles; and 30 percent upward flexibility for flights above 400 miles. The percentages are based on the standard industry fare level. This new flexibility is limited, at least for now, to flights within the 48 contiguous States and the District of Columbia. The Puerto Rico/Virgin Islands, Hawaii, and Alaska markets will be addressed later in other policy statements.

The Board announced at the meeting that the policy would become effective the next day (May 14). Meanwhile, certain United States Senators filed a Motion for Reconsideration, and Ralph Nader and the Aviation Consumer Action Project filed a Motion for Stay. For the reasons discussed below, we are granting the Motion for Reconsideration, requesting comments (to be submitted by July 17, 1980 and reply comments by August 1, 1980, (PSDR-66A, also issued today), and denying the Motion for Stay.

Background

The Board's domestic fare policy in effect before the May 13 decision was established in PS-80 (43 FR 39522, September 5, 1978), as modified by the Airline Deregulation Act of 1978, Pub. L. 95-504, and PS-92 (45 FR 24115, April 9, 1980). As set forth in 14 CFR Part 399, Subpart C, it allowed certificated air carriers, without providing justification to the Board, to establish fares ranging up to 5 percent, 10 percent, or more above the standard industry fare level (SIFL). Where four or more

carriers had nonstop authority, the upper limit was 10 percent above the SIFL. In all other markets, the upper limit was 5 percent. Local service carriers, however, could set their fares as much as 30 percent above the SIFL fare formula.[1] The downward limit of the zone of flexibility was generally 50 percent below the SIFL, and 70 percent below for up to 40 percent of a carrier's weekly available seat-miles. Finally, all carriers had unlimited upward and downward pricing freedom on flights with aircraft up to 60 seats.

The proposal

We proposed in the NPRM a wide range of options for increasing domestic fare flexibility. The regulation of route entry has been substantially ended in domestic markets; any fit carrier may enter a new route with only a minimum of waiting time, and subject only to consideration of environmental, safety, and specific local factors. The Board has been concerned, however, that the existing upward restraints on pricing, despite some liberalization, may be limiting various aspects of competition, including innovative pricing and the willingness of carriers to remain in existing markets and take risks in new ones. We also have been especially concerned about the undisputed fact that the old cost formulas upon which the fare restraints are based are biased against—that is, understate the costs of—short-haul routes. This may be causing loss of service in some of these markets, where the need for regulatory protection is less because of the availability of competitive surface transportation. Furthermore, there has been some evidence that despite frequent updating of the SIFL, airline yields have not kept pace with rapidly rising costs, and there is no question that the airline industry as a whole is experiencing large losses. The Board is of the opinion that the transition to deregulation of airline pricing should not proceed from relatively tight regulation to no regulation overnight, but should include a period of relative pricing freedom while the Board is still in a position to act upon evidence of abuse or major dislocation.

The proposed options were as follows:

I: Full downward flexibility in all markets.

II: 10 percent upward flexibility in two- and three-carrier markets as already allowed in four-carrier markets.

III: Full upward flexibility for flights up to 200 miles, coupled with 30 percent upward for 200-400 mile markets. [Variations: A higher percentage or unlimited flexibility for 200-400 mile markets.]

IV: Full upward flexibility for a portion of each carrier's available seat-miles each week in each market. [Variations: Measure by month, quarter, or 6-month period; apply to system instead of each market.]

V: 30 percent upward flexibility in all markets. [Variations: 50 percent upward for 0-200- or 0-400-mile markets.]

VI: Full upward flexibility in all markets.

The comments

Twenty-three comments were filed in response to the NPRM, by air carriers, air carrier organizations, civic parties, consumer representatives, and others. A list of the commenters is attached as an Appendix. Most supported and none objected to Option I, full downward fare flexibility. We find little or no public interest in inhibiting fare reductions, and therefore we have adopted Option I. Predation continues to be a basis for suspension at any fare level, under guidelines set forth at § 399.32(b).

The comments on upward flexibility varied. The Airline Passengers Association, New York State Department of Transportation, and most of the air carriers supported full upward flexibility. They argued that this approach would best enable carriers to set prices to recover costs and meet consumer demand, and that actual and potential competition are now adequate to prevent abuse of market power. The carriers pointed out the current rapid financial deterioration of much of the airline industry, and the need for substantially greater management freedom to find its way through the crisis. They argued that unlimited pricing freedom is needed to provide the public with greater price and service options, to allow innovation by management, and forestall excessive service discontinuances.

USAir stated that we do not have the authority to adopt full upward flexibility, and suggested instead that we set the upper limit of the zone at 50 percent above SIFL in all markets. TWA suggested 30 percent as a general upper limit, with a possible 50 percent in short-haul markets and 5 percent in monopoly markets. Most

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[1] By "SIFL" we mean the predominant fare in effect on July 1, 1977, as updated periodically for cost increases, unless otherwise specified. The "SIFL fare formula" refers to the updated Domestic Passenger Fare Investigation fare formula published by the Board from time to time in accordance with section 1002(d)(6)(B) of the Federal Aviation Act.

supporters of increased upward flexibility opposed Option IV (full upward flexibility for a portion of each carrier's available seat-miles) as administratively unworkable. Bell Helicopter supported a combination of that option for markets over 400 miles with broader flexibility (Option III) for the short-haul markets. Also supporting broader flexibility in short-haul markets than elsewhere were Republic Airlines and, as an alternative to full upward flexibility, Piedmont Aviation. Several commenters urged that we treat all markets consistently, rather than distinguishing by flight length. They argued that such distinctions would continue distorted allocation of resources caused by regulatory controls.

The commenters opposing substantially broadened upward fare flexibility were the U.S. Office of Consumer Affairs (Esther Peterson), Ralph Nader and the Aviation Consumer Action Project (Nader/ACAP), the Commonwealth of Puerto Rico, and the Indianapolis Airport Authority. Puerto Rico discussed only Mainland-Puerto Rico markets, which we will address in a later document.

Esther Peterson and Nader/ACAP argued that our proposal was inconsistent with the Congressional intent to deregulate domestic air transportation on a fixed timetable. They noted that the Airline Deregulation Act of 1978 specifies December 31, 1981, as the end of our authority over routes (except for fitness determinations), and January 1, 1983, as the end of our authority over fares. They noted also that the Deregulation Act explicitly authorizes us to widen the statutory zone of reasonableness downwards but is silent on raising the upper limits, and argued that this prohibits our proposed increases in upward fare flexibility. Nader/ACAP argued further that the statutory flexibility of 5 percent over a level that is frequently updated for cost increases is adequate, and that broadening this zone would be an abdication of the Board's duty to protect the traveling public from unjustified price increases. Indianapolis argued that, despite the Board's liberal entry policies, competition is not yet strong enough to warrant any substantial increases in upward flexibility. Urging us to proceed more gradually, Indianapolis suggested that carriers wishing to increase prices more than 10 percent above the SIFL in a market should have to offer equivalent price reductions for the same amount of capacity in that market during off-peak hours or days.

Response to Comments

On the basis of the comments and the reasoning set forth in the NPRM, we have decided to establish the full/50/30 percent scheme of upward flexibility discussed above. This is a combination of the proposed Options III and V.

At the outset, we reject the argument that we have no authority to establish zones of fare flexibility that are broader than the one set forth in the Airline Deregulation Act. The statutory zone represents a range within which Congress chose to guarantee flexibility to air carriers by eliminating Board jurisdiction over the reasonableness of fares. As we stated in PS-92 when adopting 10 percent upward flexibility in certain markets,

"By now allowing the carriers some pricing flexibility above the ceiling with limited risk of suspension, we are simply establishing guidelines for the exercise of our discretionary suspension power. We are not relinquishing our *jurisdiction* over fares outside the statutory zone. In this regard, [the] observation that Congress has expressly given us the authority to disclaim jurisdiction over the reasonableness of fares below the floor of the statutory zone by increasing the downward zone but failed to give us similar authority to increase the upward zone is correct. But it is not relevant." (Italic in original.)

We are retaining jurisdiction over the reasonableness of all fares that are outside the statutory zone, including those within the new limits. We can investigate any such fare and find it unlawful. The new policy merely states that we will ordinarily not suspend it while an investigation is in progress. Moreover, we will suspend a fare within the new limits when necessary, that is, when we find an abuse of market power that we do not expect to be corrected through marketplace forces. This might occur in markets that are subject to airport slot constraints, for example, or that involve isolated small communities.

We disagree also with the argument set forth by the Indianapolis Airport Authority that the current state of competition is such that a substantial increase in fare flexibility is inadvisable. Indianapolis stated that in 1979, a group of 17 new entrants collectively offered only 2 percent of industry capacity and carried only 6 percent of the traffic. It argued further that competition between existing certificated carriers is not effective, in that these carriers emphasize service competition over price competition on all but the most lucrative routes.

It is our judgment that competition faced by the certificated airlines, especially among themselves, is far sharper than the picture posed by Indianapolis. Also, in the shorter routes commuter airlines, which are not reflected in the figures cited by Indianapolis, provide competition that has substantially increased since passage of

the Deregulation Act. More importantly, however, it is our opinion that the discipline of the marketplace cannot be simply measured by looking at the overt behavior of the existing carriers or the number of carriers in a given market. This subject is discussed in detail in Appendix D of the NPRM. The Board's fundamental policy premise, and that of the Airline Deregulation Act itself, is that the prices set by the sellers of services, where unhindered by restricted entry or governmentally-applied limits, tend to be the "right" price in terms of costs and efficient utilization of resources, whether or not the sellers indulge overtly in the frequent price movements that are commonly associated with "price competition." The public's acceptance or rejection of the carriers' services is the chief restraining force, reinforced by the threat or reality of new entry in those cases where a carrier is exploiting a special situation with monopolistic behavior. We cannot accept Indianapolis' underlying premise that government price regulation is needed in all cases except those where carriers are behaving in some approved manner. If that were valid, general deregulation of air fares would probably be never achievable, and never justified.

We rejected Option II, which would have merely extended 10 percent upward flexibility from four-carrier markets to all markets, as inadequate. We must set the upper limit high enough so carriers will have to decide for themselves how much to increase fares, rather than ritually taking the entire increase authorized each time we update the SIFL for industry-wide cost increases.

We rejected Option IV because we agreed with the commenters that allowing flexibility on a portion of a carrier's available seat-miles would be too complex for both carriers and the Board to administer. Linking prices more than 10 percent over SIFL to equivalent price reductions in the same markets, as suggested by Indianapolis, would be similarly unworkable.

We rejected Option VI because full upward flexibility in all markets is not necessary at this time. The combination of Options III and V that we have selected appears to provide enough flexibility while preserving a measure of Board oversight during the transition to full pricing deregulation on Janunary 1, 1983.

From proposed Option III we have selected unlimited upward flexibility for markets up to 200 miles. As discussed in detail in the NPRM, the SIFL is based on a formula that is biased against short-haul markets. It understates the costs of providing jet service most severely in the markets under 200 miles. We do not want our fare policy to force jet aircraft out of shorter-haul markets because they are uneconomic without giving carriers the opportunity to see if the community is willing to purchase jet service at a higher fare. To some extent the previous fare ceiling may have already caused some certificated carriers to leave markets that they might otherwise have retained. For example, in early 1979 many intra-California routes came under Federal jurisdiction for the first time. Fares in those markets had been held at low levels by the State's Public Utilities Commission. When Hughes Airwest filed with the Board to raise fares to the interstate SIFL we suspended the fares and issued a rule to phase in higher fares in California, despite the carrier's objection that the fares were uneconomic. Our attempt to help the consumer by constraining fare increases was followed by a withdrawal by certificated carriers from some short-haul California markets. Given a choice, communities may prefer a less expensive commuter service in these markets, but again that decision can and should be made by consumers in the marketplace. It should not be the inevitable outcome of a Federal regulatory policy that effectively dictates the type of service to be delivered in a market.

If it appeared that there were many situations, among markets of less than 200 miles, in which monopolistic behavior might even transitionally lead to unreasonably high fares, we would not eliminate the ceiling. But these markets are very competitive. Nearly 40 percent of the service is provided by commuter airlines. The fares of these carriers have never been regulated by the Board, yet they have rarely been more than 30 percent above the SIFL, even in their monopoly markets. In addition to commuters, whose costs are lower than jet operators', pricing competition in these markets comes from the automobile, bus, and, to a lesser extent, the train. Appendix B of the NPRM shows that for a trip up to almost 150 miles it is less expensive to drive than to fly. And, if there is more than one person traveling, ground travel becomes very competitive even for longer trips. These observations are similar to the results of a study by Boeing Aircraft, a copy of which has been placed in the docket.

For markets between 200 and 400 miles we have chosen 50 percent upward flexibility, also from Option III. In this range the SIFL formula is still distorting, and we did not believe that a 30-percent zone would give enough flexibility in all cases to cover costs, invite new entry and develop more innovative pricing schemes. On the other hand, the distortion is less, and the absolute amounts of the fares are higher, so that on balance a 50 percent upward zone appears sufficient at this time.

For markets over 400 miles, the formula from which the SIFL derives was designed so that coach fares would be at or above average costs. The 30 percent upper limit of Option V therefore appears to provide ample flexibility. It also enables us to adjust the SIFL for cost increases twice a year, as set forth in section 1002(d) of the Act, instead of more often as we have been doing recently under the pressure of rapidly escalating fuel costs.

Grant of reconsideration

After the May 13 announcement and while this interim policy statement was being prepared, 11 U.S. Senators filed a motion for reconsideration. While noting that we had followed proper rulemaking procedures, and that the action was "effective on an interim basis," they stated that the action chosen by the Board was unexpected, and had generated considerable interest among public officials and local communities that had not filed comments. They urged that we grant reconsideration and allow another round of public comments. We are granting the motion. The new policy was intended from its inception to be an interim one, with our reexamination to begin immediately. A further round of comments will be useful for several reasons. The publicity following the May 13 announcement has generated widespread interest in fare flexibility among persons who did not comment on the NPRM. In addition, commenters can now focus on a single policy instead of having to address a broad range of alternatives. Finally, further comments can help us in assessing the actual effects of the new policy. By PSDR-66A, also issued today, we are requesting comment on this interim policy statement, to be submitted by July 17, 1980 with reply comments by August 1, 1980.

Denial of stay

Nader/ACAP filed a motion to the Board to stay "its decision concerning upward fare flexibility made at the 'sunshine meeting' on May 13, 1980." The motion noted the standards set forth by the U.S. Court of Appeals for the D.C. Circuit for a court deciding whether to stay a final agency action, and argued that they apply to and are satisfied by this case: (a) Whether the petitioner has made a strong showing that it is likely to prevail on the merits; (b) whether the petitioner has shown that without such relief it will be irreparably injured; (c) whether the issuance of a stay would substantially harm other parties interested in the proceedings; and (d) where the public interest lies. (*Washington Metropolitan Area Transit Comm.* v. *Holiday Tours*, 550 F.2d 841 (D.C. Cir. 1977).) For the reasons that follow, we deny that motion.

1. The policy statement is not an appropriate stage at which to review the Board's action. The policy statement by itself makes no changes in any airline fares. For any such change to take place, an air carrier must file a tariff with the Board, against which any parties, including the petitioners, may file a complaint. If and when the Board dismissed the complaint, that would be a more appropriate point for any administrative or judicial review action petitioners wished to take. This distinction is not merely a mater of timing, although that is important enough. The policy statement zones are not rules. Tariffs filed for fares within the zones may be suspended upon a clear showing of abuse of market power that the Board does not expect to be corrected through marketplace forces. Conversely, tariffs filed for fares outside the zones may be accepted by the Board if they are sufficiently justified by the carrier filing them. Thus, the policy statement should not be a candidate for any type of stay or other review action at this time.

2. The likelihood of success on the merits is insubstantial. Opinions may indeed differ as to whether the Board action was envisioned by Congress when it enacted the Deregulation Act. But it is clear from section 1002 and cases interpreting virtually identical suspension provisions in other statutes that Congress has given the Board the power to do what it did. As pointed out above, in setting up the statutory fare flexibility zones, Congress removed Board jurisdiction within those areas. But the Board's administratively-established zones have a different effect—they establish guidelines for use of discretionary suspension power, not for a relinquishing of jurisdiction. As such they in no way conflict with the statutory zones.

3. Not only have Nader/ACAP failed to show that they or anyone else would be irreparably injured by not staying the policy statement, they have not shown, nor can imagine how they could show, that they would be injured at all. Their arguments read as if the action mandates a large increase in all air fares. To the contrary, the Board's action gives the airlines increased flexibility to decide what fares they will charge.

Miscellaneous

We take this occasion to clarify our policy about fares for through service and online connecting service. That policy has long been to allow a carrier to set fares up

to the sum of the local fares minus one terminal charge for each local fare after the first. It appears now in a new § 399.33(c). Since this amendment is a general statement of policy that has already been in effect, the Board finds that notice and public procedure are unnecessary and contrary to the public interest and that the amendment may become effective immediately.

The final rule also restores § 399.35, which sets out Board policy on Special Tariff Permission. That section was adopted in PS-91 (45 FR 20071, March 27, 1980) and inadvertently deleted by PS-92 (45 FR 24115, April 9, 1980). Since this restoration of § 399.35 merely corrects a clerical error in a policy statement and makes no substantive change, the Board finds that notice and public procedure are unnecessary and contrary to the public interest and that the amendment may become effective immediately.

All Members concurred in the adoption of the Policy Statement except Member Schaffer who filed the following dissenting statement:

Schaffer, member, dissenting:

Without question, circumstances call for the Board to extend a greater measure of fare flexibility to our domestic air carriers. In fact, present difficult economic circumstances make the case for increased pricing flexibility compelling. For pricing flexibility to work, or for that matter for price experimentation to be encouraged, the carriers must have an expanded zone of flexibility.

Unfortunately, the severe inflation of the past year, particularly the rapidly escalating price of fuel has all but neutralized the effect of the fare flexibility provisions of the ADA. When one adds the uncontrollable regulatory lag required by the ratemaking process, it readily becomes apparent that the limited upward fare flexibility now available—5 or 10 percent for trunk carriers and 30 percent for locals—does not provide a sufficiently large zone for carriers to experiment. What happens in such circumstances and unfortunately what we have seen for the past year is that the SIFL—the base from which the zone of reasonableness is calculated—becomes the upward price leader. The industry, responding to rapidly escalating costs, can do nothing more than follow the lead of the recalculated SIFL by uniformly adopting, on an across-the-board basis, whatever increases our calculations allow.

Thus, I agree with my colleagues that an additional measure of pricing flexibility is necessary now. I have already indicated that I favor additional upward fare flexibility, perhaps as much as 30 percent across the board. I differ with my colleagues on the method chosen, a proposal which embodies a system of a market differentiation based on distance: unlimited upward flexibility in short-haul markets up to 200 miles, 50 percent in markets between 200 and 400 miles and 30 percent in markets over 400 miles. In short, my main concern is the magnitude of the flexibility granted in short-haul markets, particularly the unlimited flexibility granted in markets under 200 miles, and the fact that the Board's action can be perceived as discriminating against those very short-haul, less dense markets that have already borne the brunt of excessive service cutbacks and abnormally high fare increases. Consumers of air transportation in many short-haul markets have already suffered adversely from the effect of airline deregulation. The Board's action in these markets seems to single out these beleaguered airline consumers unfairly, subjecting them to potentially greater air fare cost escalation than those consumers in the long-haul markets. Thus, in the absence of compelling evidence to the contrary, I believe that the 30 percent ceiling for long-haul flights would, in the vast majority of markets, permit price variations sufficient to justify the continuation of jet service for short-haul flights. Accordingly, I would accept that ceiling for all flights on an across-the-baord basis.

The lack of evidence that additional flexibility is needed in short-haul markets is demonstrated by the fact that the initial impetus for additional fare flexibility has come from the trunk carriers and among them those generally serving long-haul routes. It is apparent that the additional measure of fare flexibility available to local service carriers as a result of DPFI generally is sufficient to allow them, carriers serving predominantly shorter haul rotes, to cover the higher costs of short-haul jet aircraft operations. it seems anomalous to take action which could have the effect of substantially increasing the relative level of short-haul fares when the remedy was designed to cure a different ailment; it is primarily the poor performance of the trunk carriers that has been the motivating factor for Board action in granting greater fare flexibility at this time. While it is true that some local service carriers have reported losses recently, that segment of the industry has been generally healthy; the local service carriers seem to have responded better to a deregulated environment than the trunks and an additional 30 percent zone, rather than 50 percent or unlimited flexibility should afford the locals, and trunk carriers serving short-haul markets who would be allowed to match their fares, a full measure of flexibility to price their product competitively.

On the other hand, I appreciate that the cost characteristics of short-haul markets in which large jet aircraft are utilized may be incompatible with the SIFL cost curve and that this variation provides justification for a distinction based on mileage. However, in my view, it would be better to abrogate the distortions of the DPFI by adopting a zone large enough to make the differences meaningless, rather than to perpetuate them as the majority has done. By such action we avoid the distortions inherent in a plan which, while allowing carriers total freedom to price their product in some markets, could be perceived as permitting them to abuse their market power in shorter haul, less dense markets, without any guarantee that the passenger will receive improved service to offset increased fares. It is doubtful, as the California experience has shown, that the increased flexibility afforded by the Board above and beyond that available in long-haul markets will either cause a shift of large jet aircraft service back to short-haul service or will slow down large aircraft service reductions.

Insofar as it allows total pricing freedom in some markets now—those under 200 miles—rather than in 1983, the Board's interim rule seems inconsistent with the Congressionally mandated scheme of the ADA. Similarly, the scheme of the Act was to limit, if not eliminate, the discriminatory treatment of different types of markets. To the extent that the Board's action perpetuates those distinctions, Congressional intent appears to have been violated a second time. Congress was aware of the distortion inherent in the DPFI cost curve when it utilized it as a basis for the zone of reasonableness enacted into law. Cost increases were to be recognized by the Board at least twice yearly and the zone was to shift to reflect those changes in the same way for all markets and all carriers. To the extent that the present Board rule appears to discriminate on the basis of distance, I believe it inconsistent with the scheme of the Act which sets the transition to full deregulation in motion.

I also see danger in allowing total upward fare flexibility in markets where there are major airport access problems. It is dangerous, in my judgment, to allow unlimited freedom, even if subject to CAB oversight, in many constrained short-haul routes particularly in the East. Numerous important short-haul markets, many under 200 miles, involve service at airports which are capacity controlled or at which potential competition is not and cannot be effective in controlling the pricing decisions of the incumbents. The best examples of the former are Washington National and LaGuardia and the protection accorded to Eastern in the conduct of its short-haul shuttle operation between Washington and New York, and New York and Boston. No competitor could offer to provide an effective competing service because of its inability to secure slots at both National in Washington and LaGuardia in New York. Potential competition may also be ineffective in many Atlanta markets because of the synergistic effect of networking enjoyed by Delta and Eastern. Obviously, these are the markets where price controls are justified, if they are justified anywhere. Yet the Board would remove all controls for short-haul markets under 200 miles, and permit a higher flexibility ceiling for short-haul markets under 400 miles without reference to the possible adverse effects upon the consumer of air transportation.

Actions by many carriers in recent days provide ample evidence that the industry has not yet been able to avoid the bad habits that have characterized pricing strategy and initiatives in the past. Since promulgation of the interim rule, many carriers have sought additional across-the-board fare increases without reference to the differing cost and demand characteristics of individual or groups of markets. While some increases have not been uniformly applied, the carriers do not yet seem to recognize that pricing strategies should be based on cost and demand characteristics that vary from market to market. While this suggests that there is nothing to lose from allowing differentials based on distance since the airlines will price on a uniform basis anyway, it does demonstrate that the carrier managements may be insensitive to differences in demand characteristics and may be induced to take whatever increase they can get, whenever they can get it, to the detriment of the shorter haul markets where greater freedom will be allowed. It appears to me that a 30 percent flexibility band is more than enough to permit adequate increases in short-haul markets while protecting the consumer from bearing a disproportionate burden of increased prices.

For these reasons I dissent from the Board's interim rule on fare flexibility.

GLORIA SCHAFFER

Accordingly, the Civil Aeronautics Board amends Subpart C of 14 CFR Part 399, Statements of General Policy, as follows:

1. The Table of Contents is amended by adding a new § 399.35, to read

Subpart C.—Policies Relating to Rates and Tariffs

Sec.

. . . . . .

399.35 Special Tariff Permission.

. . . . . .

2. Section 399.32 is amended to read:

§ 399.32 Zone of limited suspension for domestic passenger fares.

(a) *Applicability.*—This section sets forth the Board's policy on passenger fares for scheduled service by certificated air carriers within the 48 contiguous states and the District of Columbia, except to the extent that greater flexibility is set forth in § 399.33.

(b) *Downward flexibility.*—Each carrier may set fares in each market at any amount below the SIFL. The Board will not suspend such a fare on the ground that its level is unreasonable, except in the following extraordinary circumstances:

(1) There is a high probability that the fare would be found to be unlawful after investigation;

(2) There is a substantial likelihood that the fare is predatory so that there would be an immediate and irreparable harm to competition if the fare were allowed to go into effect;

(3) The harm to competition is greater than the injury to the traveling public if the proposed fare were unavailable; and

(4) The suspension is in the public interest.

(c) [Reserved]

(d) *Upward Flexibility.*—Each carrier may set fares above the SIFL as follows, and where they are so set, the Board will not suspend them on the ground that their level is unreasonable except upon a clear showing of abuse of market power that the Board does not expect to be corrected through marketplace forces:

(1) At any level, for markets whose shortest authorized airport-to-airport mileage is less than or equal to 200 miles;

(2) Up to 50 percent above the SIFL, for markets whose shortest authorized airport-to-airport mileage is more than 200 miles but not more than 400 miles; and

(3) Up to 30 percent above the SIFL in all other markets.

(e) *Fares above the zone.*—Tariff filings that state fares above the applicable zone must include the data and information set forth in § 221.165 of this chapter. For peak fares, this must include a description of the carrier's off-peak fares that are available in the market. The Board will suspend a fare above the zone that it finds not to be justified by cost or competitive factors.

3. In § 399.33, paragraph (c), Local service carriers, is retitled and amended to read:

§ 399.33 Additional fare flexibility.

For scheduled service within the 48 contiguous States and the District of Columbia, certificated air carriers have the following fare flexibility in addition to that set forth in § 399.32:

. . . . . .

(c) *Through service and on-line connecting service.*—For through service and on-line connecting service, carriers may set their fares up to the sum of the local fares minus one tax-rounded coach ceiling terminal charge for each local fare after the first, if that level is higher than the ceiling set forth in § 399.32(d). The Board will not suspend such a fare on the ground that its level is unreasonable except upon a clear showing of abuse of market power that the Board does not expect to be corrected through market place forces.

4. A new § 399.35 is added, to read:

§ 399.35 Special Tariff Permission.

(a) *Definition.*—As used in this section, "to grant STP" means to approve a carrier's application for Special Tariff Permission to file a tariff on less than the statutory notice set forth in § 221.160(a) of this chapter.

(b) *Lower fares, rates, and charges.*—It is the policy of the Board to grant STP for tariffs that state lower fares, rates, or charges and any rules affecting only those lower fares, rates, or charges, except that:

(1) The Board will not grant STP to match a tariff filed on Statutory notice; and

(2) The Board will not grant STP if the proposed fares, rates, charges or rules raise significant questions of lawfulness, that is, could reasonably be expected to be found unjust or unreasonable, unjustly discriminatory, unduly preferential, unduly prejudicial, or predatory, under current statutory or Board guidelines. In these

situations, if the carrier files the tariff on statutory notice and at the same time applies for STP to advance the tariff's effective date, the Board will use its best efforts to act within 15 days to grant or deny STP.

(c) *Higher fares.*—For tariffs that state higher passenger fares, and any rules affecting only those fares, the Board's policy on STP is, except in unusual or emergency circumstances:

(1) To grant STP if the resulting fares are within a statutory or Board-established zone of presumed lawfulness; and

(2) Otherwise, to deny STP.

(Secs. 204, 403, 404, and 1002 of the Federal Aviation Act of 1958, as amended, 72 Stat. 743, 758, 765, and 788, as amended, 49 U.S.C. 1324, 1373, 1374, and 1482.)

By the Civil Aeronautics Board:

PHYLLIS T. KAYLOR, *Secretary.*

APPENDIX.—COMMENTS ON PSDR-66

Airline Passengers Association.
Air Transport Association of America (on behalf of certain carrier members).
Aloha Airlines.
American Airlines.
Bell Helicopter Textron.
Big Sky Airlines.
Braniff Airways.
Commonwealth of Puerto Rico.
Commuter Airline Association of America.
Continental Air Lines.
Delta Air Lines.
Hawaiian Airlines.
Indianapolis Airport Authority.
New York State Department of Transportation.
Pacific Southwest Airlines.
Pan American World Airways.
Piedmont Aviation.
Ralph Nader and the Aviation Consumer Action Project.
Republic Airlines.
Trans World Airlines.
United Air Lines.
USAir.
U.S. Office of Consumer Affairs (Esther Peterson).

The CHAIRMAN. Thank you very much, Mr. Chairman. And I will begin the questioning by emphasizing that my intent is not to argue with your rationale for increased flexibility. On that broad concept I agree with you.

But I am most confused by your statement—on the one hand, you argue that the Board's fare flexibility rule to increase fares is needed to prevent "catastrophic" results for individual carriers and the industry; that the rule may permit the retention of jet service to some small communities; and that by erring on the low side of added flexibility we may "severly cripple the industry, stifle its growth, reduce competition, and reduce consumer benefits. . ."

On the other hand, you argue that unregulated and local carrier statistics prove the vast majority of short haul fares will stay within 30 percent of SIFL; that current economic predictions will prevent carriers from substantially raising fares, and you say, and I quote, "we feel confident that our decision to lift the fare ceiling in the shortest markets will not lead to excessive fares."

Now, it seems to me that those statements are quite contradictory. Would you address that point?

Mr. COHEN. Certainly, Mr. Chairman. Our purpose here is to allow flexibility for the carriers in differentiating among their fares, particularly. We don't anticipate that carriers are going to raise all of their fares 30 percent, or 50 percent, or as high as they want to, in the shortest haul markets.

What we do anticipate is that many carriers will be able to differentiate price so that they can price higher to time-sensitive travelers who require on-demand service, and for whom the scheduled service is particularly designed, which could then allow them to price lower to the discretionary traveler.

If they were merely serving discretionary travelers, they could let the plane sit there until it was full and then take off. By being able to differentially price and to price some fares higher and some fares lower, we think they might have an opportunity to avoid such things as 20 percent decline in traffic, and they may be able to achieve higher load factors and overall benefit the public, and stay in business themselves.

It's to give them flexibility to try different things. With each—there's a diverse set of carriers there. And instead of us putting a tight lid in restricting what they can do, we wanted to give them the opportunity to try what they think might work in a very complex marketplace and a situation in which the economy is into a recession, and the increasing cost of fuel forces the overall cost of air travel upward, and has caused great problems for them. We want to give them a chance to try new things.

It isn't just one set of fares going up; it's a number of differentiated fares that we hope they will be able to develop.

The CHAIRMAN. Considering your opinion of the competition which exists in short-haul, low-density markets, and your analysis that those fares would stay reasonable, why wouldn't it be safe to assume that a 30-percent across-the-board zone would not, in fact, be catastrophic for the industry or small communities?

You see, my concern here is how this is perceived. We are talking about inflation and recession at the same time, and yet when you take the lid off of some markets, the flying public and the nonflying public, perceive that as an open-sesame type of thing.

Mr. COHEN. Mr. Chairman, I understand the point that you are making. We were quite concerned about how this would be perceived and actually what happened in this very long discussion last Tuesday at the Board meeting was really in my mind a balancing of either—it was the concern with how this would be perceived versus the concern of doing what appears to be the correct thing in the long run; that will in the long run benefit the smaller communities more.

And I was concerned that out of—if I did merely approve the 30 percent across the board, there could be some harm to small communities and some real distortions for local service carriers who are already, many of them, at 30 percent ceiling.

And it might create incentives for these carriers to pull out of short haul markets and to pull out of medium-sized communities and further exacerbate the problems that we have so far been dealing with.

The CHAIRMAN. But you said that in most of these markets, you are not at the 30 percent level.

Mr. COHEN. That's correct, but I think in 20 or 30 percent—the figures are here—in less than half of them, they are at 30 percent level, so that most of them, they are not, but a significant number of them, they are.

I have to turn back. I think the figure was 20 or 30 percent of them are in that range of 25 to 35 percent above, right now, so that their opportunities for any differential pricing are quite limited.

The CHAIRMAN. In your testimony, though, you state with respect to the fact that locals price at less than 130 percent about the SIFL, we believe that these fares are not up to ceiling because the under 200 mile markets are extremely competitive. Lower cost commuters are a real competitive threat in their short haul markets. Yet in the study performed by your office of economic analysis, the results are stated as follows, and I quote:

> We found that the relationship between the local fare as a percentage of the DPFI fare and distance was as predicted. Additionally, the presence of a trunk carrier in markets below 400 miles did indeed have a strong negative effect on local carriers' fares; however, the presence of local service competitors, commuter competitors, and in markets over 400 miles, trunk competitors, did not have a significant impact on the local fares.

Now, how do you explain that inconsistency?

Mr. COHEN. I was looking up these numbers, and I didn't get the entire question. Let me turn to Dr. Frank and let him explain; it's his report and in his words.

Mr. FRANK. The finding in the studies that showed the local carriers' fares were the same whether there was another local service carrier present, we took it to mean that surface competition and potential entry in the event that fares went above cost did indeed serve as a strict force to limit latitude by carriers serving markets of that type where we found it—where a trunk carrier was present, the fare on average was quite a bit lower than other markets.

I think that suggests a different interpretation. Trunk carriers were constrained at the time and until only a few days ago were constrained not to charge a price more than 10 percent above the standard industry fare level, so any market that a trunk voluntarily continued to serve—and after all, that was the only kind of market that survived in our sample—would have to have a fare offered by the trunk carrier no more than 10 percent above the standard industry fare level.

If a commuter or local service carrier could not match that fare, it would have to get out, because it couldn't hope to compete with the trunk on that basis. So I think what we had in our sample was a collection of markets where, because of high traffic density or some other characteristic of the market, that made it cheap enough to serve and survive at a profit and a fare only 10 percent above the standard level. Some trunks were willing to stay in. So I don't think it was the competition by trunks per se; it was the cost characteristics of those markets that let trunks stay in that led to that association of numbers.

The significant finding of the study was that local service carriers, even when they were by themselves, priced in about the same way in a market of given distance and traffic density as they did in markets where other local service carriers were competing head to head with them, that suggested the strength of the potential competition was indeed real and did act as a constraint for some pricing.

The CHAIRMAN. Based on that, then, wouldn't you be justified in giving the same protection to small communities that you do to other communities that are served on the longer stage lines.

Mr. FRANK. I think as Chairman Cohen pointed out, I think while most communities were not at the 30-percent ceiling served by local service carriers, a very significant number were, which suggests that there may be many communities for whom the fare ceilings are also standing in the way of the ability to get the carriers to provide the kinds of services that the public wants to buy.

It was the desire to have the marketplace resolve those service decisions, rather than the Board, I think that influenced the Board most strongly to try and put the ceiling fare enough to the right that the market would be able to do that.

The CHAIRMAN. Now you point out that the 30-percent ceiling of the locals may not be high enough, because the locals are losing money. Then you note in your statement that increased fares are not synonymous with increased profitability.

How can you continually justify your fare flexibility rule on the basis of the need for industry profitablity when higher fares will likely drive off more passengers, just as you've showed in your chart there?

Mr. COHEN. Mr. Chairman, maybe Dr. Bailey would like to answer that. The answer is really a question of, we're not talking about one fare, a single fare for every airplane, we're talking about a whole variety of fares. Some of those fares can go up and they may go up above the 30 percent or up to the 30 percent or up to the 50 percent on occasion.

But that will allow—that won't be for everybody who gets on the airplane. That will allow the airline or could allow the airline to reduce fares for the discretionary traveler in an effort to keep the airlines full in order to cover costs and make some kind of profit so that they can look around to buying more efficient airplanes in the long run.

This is quite a diverse industry, and the pricing techniques are a diverse set of pricing techniques. We're not talking about one price for all the seats on one airplane; we're talking about giving them flexibility so that they can charge a lot for some of the seats and a lot less for many of the other seats in their efforts to keep them full.

Maybe Dr. Bailey would like to expand on that.

Ms. BAILEY. I think what I would like to do is to present you with an alternative idea that we had at the Board when we were discussing what to do in the fare flexibility.

That was an idea in which we would grant people the flexibility to either charge an additional up to, say, $30 or 30 percent. Our idea there was that the advantage of it was what you have been saying, that that $30 would then be a cap. You couldn't go up some $150 or $200 or something like that in a short-haul market. You would have a limited amount of additional flexibility.

The reason that we decided against it is because in some little markets in which it was only like a $15 or $20 fare, that would seem like a very high percentage and might mask what we're really attempting to do.

The CHAIRMAN. But at least it would provide some protection where you don't provide any protection now without leaving some kind of a cap in those markets.

Mr. COHEN. On this question of protection, Mr. Chairman, I'm glad you got back to that, because I meant to address that.

We have given it a great deal of attention and thought, and will continue to do so. We are not walking away from the zero to 200 markets. We are not walking away from the 200 to 400 markets. We are most concerned that we continue to monitor markets and we continue to monitor what happens in all these markets.

We think that it's important to take these steps now while we have the power to do something about it. If it turns out that we are wrong, I must admit to human fallability. We are making our best effort to do what is right in this situation, given all of the facts and all of the evidence before us and all of the different ideas of all of the participants, and we have made what we think is the best judgment, will work the best for the public benefit, but we are not walking away from any of these markets, and we are not leaving anything unprotected, Mr. Chairman.

We retain the power to step back in at any time.

Ms. BAILEY. I will mention, that although in some areas, data is already being collected, in this area, we can use the official Airline Guide. We get tapes from them, so essentially on the day when that comes out, we can get both pricing information and market-by-market information which we can analyze. We have asked our staff for that kind of analysis, and we expect within 5 days of the publication of an official Airline Guide, we will be able to essentially look and see if there are any outlying markets and look at summary kind of data by mileage bands.

So we are, I think, going to attempt in a very responsible way to observe what is taking place as it takes place, not coming back here later and saying, "Gee, we made a mistake 1 year ago."

This is something that we really can look at as it comes in. That particular data part of our operation at the CAB is very efficient and effective at getting this kind of information to us on a very timely basis.

The CHAIRMAN. I must say I'm glad to hear that the CAB is in a position to take some actions on a very quick and timely basis, because one of the complaints that we have had in the past is the fact that they have failed to act on a timely basis and that that has accounted for some of the problems that some of the carriers complain about.

It would seem to me, if we applied your profitability fare increase rationale to the pricing, that we would have them raising the price of the automobiles now instead of giving rebates to try and improve their profitability.

Mr. COHEN. Mr. Chairman, Chrysler is free to price however it pleases and doesn't have the Government telling it precisely what to do in the pricing area.

We hope, and we will have to wait and see what the carriers do, because we think they are fairly intelligent and enlightened businessmen for the most part, and we hope that they will take some lessons from the rest of the economy and be in a position to offer lower fares.

When we talk here about an effect of what we're doing, we're talking about an average effect. We think the average effect will not be to see 30 percent or 50 percent increase, but in order to achieve that average and be able to charge local prices, lower fares for some, that means they're going to have to charge higher for others.

Ms. BAILEY. The other factor connected with that, that is when you're in a period of time in which you are very tightly squeezed on your returns and your profits, and you have got a cap on what you can charge on a ceiling, you're not going to be very much moved to experiment on the low end. You're going to try to get every last cent that you can.

Only by having a little elbow room, we think, can you experiment essentially in both directions. Otherwise, you're going to get nervous and try to hold every last dollar, just because of the uncertainty and because of the fear.

The CHAIRMAN. How does the Board's action fit into the administration's wage and price guideline policy?

Mr. COHEN. Mr. Chairman, I don't think any element of the administration has sought mandatory price controls. What we are doing is removing a mandatory ceiling and giving flexibility, and then the carriers can make their own decisions about pricing in accordance with their costs.

The CHAIRMAN. Yes; but you automatically are going very markedly above the price guideline policy, aren't you?

Mr. COHEN. We are merely removing a mandatory ceiling and letting the carriers decide on their pricing within that zone. We're not setting a price ourselves at all, Mr. Chairman.

Ms. BAILEY. It might be interesting to review for the Senator somewhat what has happened in the industry over the past week, like I noticed a declaration from Piedmont yesterday that it was not intending to take any advantage of the ceiling. There have been one or two carriers that have had very small increases and one carrier that's declared it's going to try for very sweeping increases. But we found a great diversity in the industry in the kinds of responses that they're having.

The CHAIRMAN. Do you intend to jawbone with the industry, as Mr. Kahn does on some occasions in this area?

Mr. COHEN. I have not intended to do so, no. I believe I may be wrong, but I believe that the carriers functioning within the zones of flexibility are subject to voluntary price controls. I might be incorrect about that because of our jurisdiction, but I do not have any intention to jawbone with the carriers.

What we do intend to do is watch and see what they do. If it looks like they are causing—gouging the public or taking advantage of monopoly powers, acting irresponsibly, we have the power to step back in and regulate them more tightly.

I don't want to try to substitute my judgment for theirs in how to run their companies.

The CHAIRMAN. Senator Kassebaum?

Senator KASSEBAUM. I would like to ask one question, Mr. Chairman. You said the Board would take corrective steps if they felt there had been any blatant abuses in fare flexibility zones.

What legal grounds would there be for the Board to do this and what actions could you take?

Mr. COHEN. I believe that we do have the power to investigate fares that are filed and to take action against those fares. We have been so advised both by counsel and the people who actually handle this area for the Board, that we do have the power to step in and investigate and take action against fares that we find to be unreasonable.

The CHAIRMAN. But not to suspend.

Mr. COHEN. We are by this action deciding that we won't suspend them when they are within zone. If it turns out there are serious problems, we can step back in and change them.

Within the 5-percent statute we can't suspend, but within the new zone we have just created, we have powers under which we went in and did it in the first place, and we can go back and change it, or we can go back and revise it or eliminate it.

This is not a final action, Mr. Chairman. We haven't yet put out the order. But what we have asked the staff to do is to prepare an interim order so that we can particularly retain the power to go back in quickly because this entire matter will be a continuing matter, not a final order.

The CHAIRMAN. Would the Senator yield further on that.

Wouldn't you have to go through another rulemaking proceeding to do that? Or, could you just simply go in and suspend arbitrarily?

Mr. COHEN. Let my counsel, respond, Ms. McInnis.

Ms. MCINNIS. We may not, under statute suspend fares within the statutory zone. We may investigate them, but we may not suspend them.

The decision of the Board last Tuesday was a matter of policy not to suspend fares that fall into this broader band zone. We may, however, get individual cases and decide to do so.

In any case, we can investigate any fare within the broader zones, if we decide that it should be rolled back.

Mr. COHEN. I might say that we have particularly said in the testimony, we have asked the staff to flag certain situations and said in these situations where there are, for instance, constraints--I forget what others it lists—isolated communities—where there are environmental constraints at the airports, we told the staff to check those filings on those airports, particularly carefully, and if it looks like an undue increase is being taken, to call it to our attention.

In fact, I believe we have asked them to call all of those to our attention so we can review them ourselves, filings in those markets.

The CHAIRMAN. Thank you.

Senator KASSEBAUM. That's really all I have.

I guess we went through captive shippers for the railroads. Now we have captive consumers to a certain extent.

But I am certainly in sympathy with the idea of what you are trying to accomplish.

The CHAIRMAN. You say in your statement that:

> In essence we believe the industry is sufficiently competitive, that removing the Board as the industry cartel pricing agent by setting a high zone will benefit consumers by forcing carriers to decide what fare level and structure is acceptable to the public, rather than taking increases announced by the Board.

Can you rationalize that statement with respect to the headline in yesterday's Aviation Daily which read, "Braniff to increase fares maximum allowable."

Mr. COHEN. Yes. Braniff has decided to try to just move close to the highest level allowed. No other company has decided to do that.

I think the market is going to decide whether Braniff is going to do it or not. I think their action raises some questions, some serious questions.

They have competition in a great deal of their marketplace. Their short-haul services generally are in Texas, and some of the people with whom they generally have to deal are Southwest Airlines, Texas International. And, in small communities there is a very healthy commuter system in Texas.

I have some real questions about whether Braniff will be able to do that. I believe they only have, from our look at it, 17 city pairs in which they do not have competition in the shorter hauls group.

Ms. BAILEY. And there, the question is how readily other people can enter those markets, because although many markets are characterized by having one carrier actually serve them, the name of that carrier can readily change now, and there has been a lot of entry and exit as to who that carrier will be. And I believe if Braniff attempts to price high in those markets, that they will find that there will be a potential new entrant that will essentially knock them out of the market.

Mr. COHEN. It is rather interesting in that area of the country, for instance, the Southwest entrant, the Houston-New Orleans market, within a very short time they captured a large chunk of that market, and is now the leading carrier as a brandnew entry.

So that area of the country, particularly, is wide open to entry and has really competitive carriers down there that might provide some discipline for Braniff.

The CHAIRMAN. You noted that 88 percent of the unregulated fares and the majority of local fares in markets under 200 miles, were below SIFL plus 30 percent.

Doesn't that lead one to the conclusion that SIFL plus 30 percent in the short-haul markets would be sufficient?

Mr. COHEN. Mr. Chairman, when you are dealing with commuter carriers using smaller aircraft, smaller aircraft can serve those short hauls with more cost effectiveness, with lower fares. They can serve less expensively because of the aircraft that they are using, and that are designed to serve markets of that size.

I'm not sure what the number of the exhibit is, the comparison of SIFL and tariff fares, January 1, 1980, which is five sheets from the back in the packet of things attached to my testimony—it shows that in the zero to 200 miles, and this is looking at domestic trunk and local service carriers, 49.9 percent of the markets there have fares—and these are trunk and local service, nonstop monopoly markets have fares ranging between 25 and 35 percent above SIFL in the zero to 200 markets.

Now, in those very short hauls, zero to 200 markets, half of those markets have fares that are bumping against the ceiling now. The question is, If they are bumping against the ceiling, and there are opportunities elsewhere, or if costs continue to rise and the cost curve becomes wider, will they leave those markets?

Will we then be stuck holding them in and subsidizing them until somebody new comes in?

Will the new carrier be as acceptable to the community?

Would the community rather pay an extra $10 fare and keep the trunk or local, or would the community rather have us hold the ceiling and have that carrier leave and go through the trauma of a replacement?

We are quite concerned that these fare policies of ours might have some causative effect on all of this, and we want to leave it more to the marketplace so long as we continue to watch it closely.

Ms. BAILEY. In particular with the local service carriers, if we raise the ceiling everywhere by 30 percent so that the trunks also go up to take a little more flexibility on the longer haul markets, we are concerned that the locals—that we will give them an artificial incentive to leave the short-haul markets, which are relatively less compensatory, and move into the longer haul markets. Whereas they might stay in their short-haul markets if you give them just as much flexibility in the shorter haul markets as they have in the longer haul markets.

Mr. COHEN. Mr. Chairman, as an example, for instance, one of these carriers might choose to charge 35 or 40 percent above SIFL for Friday night and Monday morning, and then be able to charge somewhat less during the rest of the week. These are the kinds of things that they might be able to do if they have the room, if given the room to experiment and to try it.

The CHAIRMAN. What was the industry reaction to your proposal?

Mr. COHEN. Most of the industry reaction was that we should take all controls off and leave them alone to try to deal with the trauma of high fuel prices and recession however they see fit.

Ms. BAILEY. I happened to have lunch with a marketing person from the industry on Wednesday, after our decision. The reaction I got was:

> I guess what you have done is tossed the ball into our court. We can't blame you any more and make you the scapegoats for what's been happening to our industry. We are going to have to essentially be responsible ourselves now for the bottom line to our shareholders. We can't say it's regulation that's doing it to us. It's got to be ourselves.

Mr. COHEN. The local service carriers, U.S. Air, Piedmont, I can remember those two, and I think PSA, filed and urged us not to just go to 30 percent overall for everybody, which would just leave them at 30 percent and not give them much of an opportunity to do anything in their pricing.

They urged us to give them some flexibility as well as the trunks.

The CHAIRMAN. So you are saying you did have some support from them for uneven applications such as you have applied?

Mr. COHEN. They asked that we take the lid off completely, or that we—in fact I believe U.S. Air supported, if I'm not mistaken—I'm going from memory— supported the proposal that we did adopt as an alternative to taking the lid off completely. Some suggested that we might just add 30 percent to everybody, which would put the locals then at 160 percent and the trunks at 130 percent. That would even give them more flexibility upward in the 200- to 400-mile range than our current action did, and it would preserve a

difference between locals and trunks that we think is not justified now, given the fact that locals are serving long-haul markets, and that all the old distinctions have been pretty well blurred.

Our distinction, Mr. Chairman, in dealing with short-haul markets was directly the result of the DPFI cost curve and the distortions that that has caused, and that we are afraid it could cause in the future.

Ms. BAILEY. Let me give you an example of the kind of thing we spotted was happening:

A carrier would leave a market such as, say, Albany-New York City, which was short haul and go into a market like Albany-Washington-Miami, which had longer flights and used the same plane to leave the one and go on to the other.

We asked ourselves why are they doing that? It appeared why they are doing that is that they can make more money going into the other route.

What we wanted to do is to have the ceiling be raised enough everywhere so that they earn the same amount of money in the one market as in the other, so you wouldn't get an artificial shift out of some kinds of markets into others. That the returns on any market could be the same as any other market.

Mr. COHEN. And the commuter carrier in some of these short-haul markets can offer cheaper service because they use more efficient aircraft. So let the community decide whether they want commuter carriers with lower fares, or a jet carrier, large-plane jet service that actually cover the cost.

We think that's a decision that ought to be left to the communities rather than being made by us.

The CHAIRMAN. When you say you are confident your decision will not lead to excessive fares in the short markets, what's the CAB's definition of an "excessive fare" for Charleston, W. V., to Pittsburgh? That's a mileage of 164 miles, and the fare is presently $62.

Mr. COHEN. I don't know. I'm not in the business of setting fares. I look to my staff for the costs and the relationship of costs to fares.

What we have found, I think, Mr. Chairman—it is a good question—what we found over the past couple of years, is that with all the differences between carriers, between markets, between airplanes, that trying to regulate fares is almost impossible. It is impossible to do it properly, to do it properly because of the tremendous differences.

That's one of the reasons, one of the fundamental reasons why so many of us supported deregulation, because we thought a marketplace and competition did a much better job of regulating fares than a Government agency.

What we are looking at is that if we found in markets where there was not a threat of entry from other carriers, when there was no threat of entry from other carriers, where there are constraints where the marketplace cannot function, that a significant increase in fares across the board would be something we would have to take a very close look at to see whether the consumers in that market were being abused or not.

To try to define it precisely, I would be playing games if I tried to do that, because I don't think it is possible to define it precisely. That's why we think the industry needs to be deregulated and moved back into the marketplace like most of the rest of our market economy.

Mr. BARCLAY. Mr. Chairman, if I could focus the argument a little bit? I think the committee's general problem with your analysis is in two parts.

No. 1, it seems to fly against the testimony we have gotten historically in regulatory actions on air transportation. I just reviewed the 1976-77 regulatory reform hearings, and if there was one thing that everyone agreed on, including CAB, DOT, Charles Foster, James Miller, the carriers, and communities, was that low density small communities which are, by admission, the majority of them, short-haul, needed some kind of fare protection on the airport side. There was no mention of the automobile, which you brought out rather pointedly in your testimony as a real competitor, when you consider a 50-minute flight as against a 4½-hour drive in a 200-mile market.

It is tough to see where that was a competitor for the inelastic part of the market, which is your business travel.

Let's take a specific example. If Washington was a small community, and New York, for argument's sake, let's say was within the 200-mile zone, the fare was $70, we had three flights a day on jets, we had a monopoly carrier, that carrier was the major carrier in New York, and there was no real threat of a new carrier competitor.

I fail to see how it would be a policeman on prices by my taking an automobile. If I am a businessman who weekly goes from New York to Washington, I'm not going to drive 4½-hours, park my car, pay the tolls and the parking and the inconvenience of a 9-hour trip every week. I am going to fly that flight even if the fare goes to $140.

Now, what protection is there for that inelastic market in the small communities, which you have given to that inelastic market in a low-density long-haul community?

Mr. COHEN. Since you are referring to all these economies, I will turn to my two economists for assistance here to supplement.

The automobile is the most—I suppose the best competition for the airline in the probably zero to 120, 130 miles. I think when you get to the 200 miles—at the 130 or perhaps 150 miles, it depends on the particular circumstances—the automobile provides real competition. I agree with you between 150 and 200 miles, it does not.

And, between 200 and 400 miles it does not.

But, we have looked at what Dr. Miller and George Eades, I guess, and others didn't have was the benefit of seeing what commuters have done in these markets. We don't regulate commuters; we don't set their price.

Now, if these communities are so subject to abuses in the 200-mile market, or 160-mile market, what about all these commuter monopoly markets that they are serving at fares well below 130 percent, because their costs are below that.

Bob, do you want to add——

Mr. BARCLAY. Mr. Chairman——

Ms. BAILEY. I would like to add something, because I just did a study on several major cities in this country. Las Vegas happened to be one of them, Milwaukee was another, in which I took a look to see just how many markets were markets that had only one carrier serving. And I did it by looking at how many flights per day went in and out.

And I found that about—even into a city like Las Vegas, about 30 percent of the markets are served by only one carrier, because they have got only one flight coming into the city.

The minute you had two round trips a day or three round trips a day, the bulk of those markets had more than one carrier—even with just three round trips a day for example, something like 70 or 80 percent of those markets had more than one carrier—one providing two round trips, and one, one round trip. The minute you got up to four or more round trips per day you were really into competitive markets.

So when you are talking about monopoly markets, you are really talking about markets that are apt to have only one round trip.

I looked at it by hub size to see whether things looked less competitive if you were talking about a small hub coming into a large hub. And, if you are talking about a medium or not a large hub coming in, the most competitive market into Las Vegas is into the Grand Canyon served by 6 different commuter carriers by 16 round trips a day. You found that, you know, you could get competition among the commuters just the way you get competition among the locals.

And, what I found, looking essentially at a lot of that entry and exit into those markets, is that it really is extremely easy for someone to come in, to drop in one extra flight a day into a city by market. It is especially true to a large hub, or if it is to a hub that has a vacation element to it.

But, I found that things were just much more competitive if you look at it now, than if you looked at it a year or two ago.

Mr. BARCLAY. I think that is exactly the point. Your general view of the marketplace is not disagreed with by the committee. And 2½ years from now they are going to accept deregulation of airfares completely.

For the time being, the worry is about markets such as Grand Junction to Denver, where the drive is over mountains and it is just not accessible and you are pretty well a captive market with one carrier, Frontier. The question is, Will commuters, with their problems right now of practical barriers to entry, of fuel availability, being able to buy fuel at reasonable prices, capacity of commuters, when our U.S. carriers are just gearing up to even build commuter airplanes, these are all real barriers to entry, so will commuters police the pricing in these markets?

Mr. COHEN. Mr. Barclay, if we waited and did this 2½ years from now——

Ms. BAILEY. He just says Continental is coming in.

Mr. BARCLAY. Cortez, Colo., where a commuter has already failed.

Mr. COHEN. If we waited 2½ years, there is no guarantee that the fuel problems of our society are going to be resolved in 2½

years. We don't know what will be happening with fuel then, we don't know what will be happening to aircraft.

We thought it would be better now when we are looking at an economy in which the carriers have to be somewhat constrained in charging too much, because the people just won't fly their airplanes. A combination of that, and the fact that there is some time to look at what happens, and that we still have the power to go back in if it turns out that we were wrong, convinced us that it was better to try to do this now when we can really monitor the situation and have a real transition, than to wait 2½ years.

We are not, as I said, just walking away.

Mr. BARCLAY. Why weren't you convinced of that in the long-haul market then as well?

I think the concern is the appearance of the Government allowing discriminate protection. It is the protective ceiling, that whether it is needed or not for the marketplace, it has been given by the Government, and they think it strikes people as discriminatory.

Mr. COHEN. The reason, Mr. Barclay, is the cost curve. We are trying to achieve the same general openness for all, and the cost curve set the base from which we started at a distorted level where prices were 20 percent and more below cost from the DPFI.

The CHAIRMAN. If you take a look at exhibit A of yours, and gave a 30-percent flexibility, you are going to get that crossover point down to about the 100-mile stage line.

Ms. BAILEY. The advantage of the dollar amount, which we also discussed, is that if you are a jet, to fly 150 miles versus 250 miles costs just about the same because most of the costs are takeoff and landing. You are not getting enough of the distance to pick up much in the way of time.

The way our curve works you get penalized—I mean, you have to charge a lot less for 150 than for 250, and the idea of giving a flat dollar amount as a band was to take that into account, and to encourage carriers independent of length of haul to maintain jet services, if it was remunerative.

The CHAIRMAN. I think, as I indicated earlier, one of the big problems here is the perception on the part of the public as to the fact that you are really not protecting the people who are from these small communities.

And I think that your testimony and your answers do a good job of justifying added flexibility for carriers to increase fares.

However, I am not convinced that you have justified the uneven protection which is the result of your specific interim rule.

If Senator Byrd asked me why airlines with or without any competition should be allowed at any time to quadruple their fares in the Charleston-Pittsburgh market, while we offer a 30-percent ceiling to passengers between New York and Los Angeles, I don't think he is going to feel any better when I tell him that he is protected by the Board's statistical analysis and assumption of competition from cars.

I think he'd be right in feeling that the long-haul markets are enjoying a measure of protection, a measure of Government protection whether they need it or not, that the short-haul markets are denied under the Board's order.

And I am hopeful that you will take another look at this and possibly reevaluate your regulation on this flexibility.

I must say that I am still not convinced that what you have done is the right thing here. I may pursue that further with you.

Do you have anything further to add?

Mr. COHEN. Thank you, Mr. Chairman.

I just might briefly indicate that there is a threat of competition that is an element in here, that was rather interesting in the Charleston-Pittsburgh routing. When United left that route, U.S. Air jumped right into it because there are people there who want to fly and who are interested in flying. They have been providing the service, and it is a good market that would attract carriers if someone tried to gouge the public there.

Mr. BARCLAY. Mr. Chairman, U.S. Air jumped in there with SIFL plus a 130-percent ceiling on prices.

Mr. COHEN. That may have been why United pulled out, because we were limiting their price to something that was below their cost.

But, we appreciate the opportunity to present testimony, Mr. Chairman, and we will continue with our consideration of this matter.

The CHAIRMAN. Thank you very much.

The hearing is adjourned.

[Whereupon, at 11:40 a.m., the hearing was adjourned.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

WILNER & SCHEINER,
Washington, D.C., May 15, 1980

Mr. CHARLES BARCLAY,
Senate Aviation Subcommittee,
Russell Senate Office Building, Washington, D.C.

DEAR CHIP: In light of the hearing scheduled for next Tuesday on the CAB decision to allow large fare increases in short-haul markets, I thought you might find useful the comments we filed with the Board on behalf of the Indianapolis Airport Authority. A copy is enclosed.

Indianapolis would like to have this document entered into the hearing record. The city's greatest concern is with the Board's decision to allow larger increases in short-haul markets at a time when certificated service is being withdrawn and commuter airlines and new entrants cannot fill the gap. The large, long-haul markets are and will attract the most competition, which will tend to hold prices to fare levels whatever ceilings the Board sets. As our comments show, this is not now the case for shorter hauls. While the smallest markets may be the most severely affected, even a city the size of Indianapolis is subjected to grave risks by the Board's decision.

One of our suggestions—that carriers be permitted to raise peak fares if they lower off-peak fares by equivalent amounts—seemed to be consistent with the Deregulation Act's intent to improve the efficiency of air service and the Board's own policy. Although specifically mentioned at the Board's meeting earlier this week, it was rejected as being "too much regulation." The Subcommittee may find this idea worth exploring with Chairman Cohen.

Sincerely yours,

PAUL Y. SELIGSON.

Enclosure.

COMMENTS OF INDIANAPOLIS AIRPORT AUTHORITY

The Indianapolis Airport Authority (Indianapolis), operator of Indianapolis International Airport, submits these comments on the Board's several alternate proposals to make its domestic fare policies more flexible in the 2½ year remaining before the full pricing deregulation mandated by Congress becomes effective.

Indianapolis is among the larger users of air transportation in the United States, ranking approximately thirtieth in the nation in enplanements. Like many substantial communities located throughout the country, but particularly those in the Middle West, its largest air markets include some relatively short hauls. Since passage of the Deregulation Act, Indianapolis has suffered serious declines in service provided by certificated carriers to Chicago (its largest origin-destination market), Detroit (third in rank), Cleveland, Cincinnati, Philadelphia, St. Louis and Kansas City. There has, of course, been some replacement of trunks and local service carriers by commuters. Likewise, while losing capacity in 15 markets in the first year after passage of the Act, Indianapolis gained service to 12 cities. But on an overall basis, Indianapolis lost 8.3 percent of its outbound scheduled available seats between October 1978 and the same month last year. Comparing schedules of April 1980 and October 1978 shows a drop of 14.8 percent. In important individual markets, losses such as the 37.1 percent to Detroit and 40.9 percent to Cleveland are not uncommon.

In short, Indianapolis thus far has found the new regulatory regime a mixed blessing, with serious problems arising in large short-haul markets, and new entry more a hope for the future than a present reality. We know our experience is shared by sister cities in America's heartland; we suspect it is not untypical of the nation as a whole.[1]

[1] Except, of course, for those communities lucky enough to be attractive tourist destinations or terminals of large transcontinental markets. But in the national picture, such cities are relatively few.

At the same time, Indianapolis recognizes and sympathizes with the current problems of the airlines. Everyone is conscious of the skyrocketing cost of fuel and the gloomy economic forecasts for the near term. We are well aware that most airlines—trunks in particular—are today suffering large losses or, at best, significant drops in profits. But we are equally aware of the extremely rapid increases in unrestricted coach fares over last year—increases at about double the rate of general price inflation.

For reasons to be explained, Indianapolis urges the Board in its current review of fare policy to exercise extreme caution. Most emphatically, this is not the time to permit full upward fare flexibility, either generally or in short-haul markets. While we do not object to a moderate further loosening of the regulatory reins, we believe any additional liberality should be structured in such a way as to promote efficiency and productivity. This can be accomplished by regulatory policies which encourage reduction in relatively unrestricted fares during off-peak periods, without which substantial increases in peak fares should be constrained or perhaps prohibited.

As we understand its reasoning, in essence the Board is saying that Congress has required complete price deregulation in 1983; a great deal of new entry has already taken place and more can come rapidly if prices get too high; present regulations tend to require short-haul flights to be priced below costs; this may be contributing to the shift away from short-haul service; alternate means of transportation will exercise price discipline in such markets; and that in the present climate of economic stress the airlines need more freedom to become more efficient.

While PSDR-66 presents the case persuasively, a good deal more needs to be said. First, Congress structured the Deregulation Act so that freedom of entry would occur well before pricing freedom. This timing was the deliberate product of extended public hearings and fierce public debate—debate which will have been notably lacking if the Board at its meeting on May 13 adopts radical changes first proposed on April 3. Congress separated route and rate deregulation by a year and left four years between passage of the Act and full pricing freedom, recognizing that actual new entry on a national level could not mushroom overnight.

True, the Board has created a system under which new route authority can be obtained very quickly and virtually for the asking, especially by established carriers. But freedom of license is not the same as actual competition. Tabulations from the May 2 Aviation Daily are highly instructive: in 1979, the trunk and local service carriers transported 89 percent of the nation's revenue passengers while operating 96 percent of the available seat miles. A group of 17 new entrants collectively offered only 2 percent of industry capacity and carried only 6 percent of the traffic. (The tables are reproduced in an attachment to these comments.)

Thus, now to rely on new entrants to police prices is premature. And, by in large, it is only the new carriers which will have cost structures low enough to offer effective price competition. While liberalized entry policy has produced many new operations by trunks and local service carriers, apart from the most lucrative routes the emphasis is still on service competition. This is only natural, considering the high seniority levels and other high costs which many years of operating under a regulatory oligopoly have induced. To allow complete pricing freedom before new, low cost airlines have had time to emerge as a significant competitive force is thus to invite very high fares over most of the mandated transition period.

As to short-haul markets, whether freedom to charge more will produce more service is highly speculative. The Board appears to be suggesting that consumers traveling up to 400 miles may be faced with a choice between greatly increased fares or reduced frequency. What we fear is that complete decontrol 30 months ahead of schedule may bring even higher prices and low frequency. In justifying its recent massive shift away from short-haul flights, United Air Lines alleged that it "is not very good at short-haul flying * * * [and] to operate profitably in these markets, United must have load factors above 90 percent."[2] This implies a need for prices to increase 50 percent for profitable operations at reasonable load factors. With the price elasticity of short-haul demand, such fare increases will greatly depress traffic.[3] The result of unconstrained pricing before there are many new carriers may well be to dry up traffic and service, with aircraft either continuing to shift to long-haul markets or being sold overseas, where they can be used more profitably at higher fares.

Furthermore, while automobile travel can be a partial substitution for air in short markets, surface transport should not be relied on to perform the regulatory func-

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[2] Docket 37884, Answer to the Objection of the State of Michigan, April 3, 1980, at 3.

[3] In the Chicago-Midway Low-Fare Service Investigation, Docket 30277, the Board found that Southwest Airlines' fares, averaging 50 percent below standard coach levels, stimulated traffic by a factor of about 2.5. Obviously, demand in short-haul markets is highly elastic, both upward and downward.

tion Congress has said should remain with the Board for another 2½ years. We submit this is unsound as a matter of policy and impractical as a matter of fact. Business travelers fly when they can, because of the value they place on their time. Few who can afford it will drive from Indianapolis to Chicago, for example, if convenient schedules are available; they will simply have to pay a higher price. And since about half the traffic is moving through, not to, O'Hare, the lower cost of driving the local hop will not restrain air's price since most airlines are now concentrating on attracting the more profitable long-haul passenger.

Finally, the Board states repeatedly that the DPFI formula, on which the SIFL is based, prices short-haul air travel below cost. This is so only if one assumes that price elasticity of demand is constant regardless of length of haul. The Phase 9 formula was developed from an elasticity coefficient of minus 0.7—a constant coefficient derived from industry-wide average experience. More recent empirical evidence shows short-haul travel demand is far more price elastic. As noted above, Southwest Airlines operating in 200–400 mile markets with very low fares and peak/off-peak pricing has stimulated demand at better than three times the rate implicit in the DPFI formula. The Southwest experience strongly suggests the following scenario if the Board allows 50 or 100 percent freedom in these markets and airlines raise fares drastically: demand will disappear and so will service—at least for the next several years, until the recession is over, capital is available at lower cost, equipment can be obtained, and new entrants with lower cost structures enter these markets charging lower prices. Meanwhile the existing industry will not have been helped and consumers will have suffered greatly because of a premature policy change made at the Board's initiative. In an extreme case, this could even lead Congress to return to tight regulation: a result no one desires.

What, then, is a sound policy course? Indianapolis suggests any modification of existing zones of reasonableness should be moderate, gradual and aimed at increasing the efficiency of existing airlines. For at least the next year or two, new carriers should be encouraged but cannot be relied upon; there simply are too few and they are too small. Measures aimed at promoting efficiency could include releasing markets from price regulation only after target load factors have been attained, for example. In short-haul markets, peak/off-peak pricing should be encouraged vigorously as means of improving productivity and increasing frequency. Alternatives 4 and 5 posed by the Board are intended to move in this direction, but as written they are more in the nature of licenses to raise fares in peak periods than inducements to decrease prices off-peak. We suggest requiring carriers wishing to increase prices more than 10 percent above the SIFL in a market to offer equivalent price reductions for the same amount of capacity in that market during off-peak hours or days.

In sum, Indianapolis is particularly concerned that the Board not cap the last year's 30 percent increase in short-haul air fares with equivalent or greater flexibility above the SIFL. For the next year or more, greater restraint should be exercised. Of the four year transition period to full pricing freedom provided by Congress, only 18 months has elapsed. While we share the Board's desire to increase short-haul service, lacking effective competition from low-cost carriers the risks for the public are too great. Under existing policy, carriers may price above the ceiling with proper justification. Addition of more service could justify a higher price, particularly if the community concurs.

There are many, more finely-tuned alternatives than the Board has proposed; we believe that before drastic final action is taken, the Board should consider these suggestions and other alternatives in a process which proceeds with greater deliberation and facilitates more public comment.

Attachment.

TABLE 1.—1979 TOTAL INDUSTRY SYSTEMWIDE PASSENGER TRAFFIC

	Revenue passengers 1979	Revenue passengers 1978	Percent change
Trunks	238,036,222	220,138,265	8.1
Local service	52,209,074	49,511,762	5.4
All cargo	195,157	208,739	(6.5)
Alaska/Hawaii	8,632,218	8,141,347	6.0
Supplementals	2,560,932	2,559,364	0.1
Other [1]	1,211,154	1,291,935	(6.3)
New entrants [2]	19,940,078	NA	
Total	322,784,835	281,851,412	

[1] Classified "Other": Air Midwest, Air New England, Aspen Airways, New York Airways, and Wright Air Lines.

[2] New entrants: Air California, Air Florida, Air Wisconsin, Altair, Big Sky, Cochise, Coleman Air Transport, Golden West, Mackey International, Midway, Miss. Valley, New Haven, PSA, Sky, Skywest, Southeast and Swift Aire.

TABLE 2.—1979 TOTAL INDUSTRY SYSTEMWIDE PASSENGER TRAFFIC

	Revenue passenger miles	Available seat miles	Load factor	
			1979	1978
Trunks	239,213,759,000	375,693,471,000	63.7	62.3
Local service	20,612,696,000	34,868,531,000	59.1	59.1
All cargo	1,098,763,000	1,271,277,000	86.4	95.0
Alaska/Hawaii	7,133,015,000	11,575,098,000	56.6	64.2
Supplemental	8,833,331,000	9,995,037,000	88.3	88.3
Other [1]	186,037,000	347,390,000	53.6	53.0
New entrants [2]	6,158,313,000	9,301,840,000	66.2	NA
Total	278,236,114,000	435,060,744,000	64.0	62.9

[1] Classified "Other": Air Midwest, Air New England, Aspen Airways, New York Airways, and Wright Air Lines.
[2] New Entrants: Air California, Air Florida, Air Wisconsin, Altair, Big Sky, Capitol, Colgan Air Transport, Golden West, Mackey International, Midway, Nitu Valley, New Haven, PSA, Skywest, Southeast, Southwest and Swift Aire.

CONTINENTAL AIRLINES
Los Angeles, Calif., May 16, 1980

Hon. HOWARD W. CANNON,
Chairman, Subcommittee on Aviation, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, D.C.

DEAR SENATOR CANNON: I understand that you are holding hearings on Tuesday, May 20, 1980, to review the CAB's recent decision to grant the airlines a measure of upward fare flexibility. As a long time advocate of deregulation, I thought you might be interested in my views.

My enthusiasm for deregulation has not changed by an iota from my days at Frontier. I support it and I fully support the general direction of the Board's decision to give us a little upward pricing flexibility. They should have gone further.

The Board has proceeded rapidly to deregulate the domestic route system. The process is virtually complete. Continental has been inundated with new competition on some of our key routes. And we have entered a number of new markets for ourselves where, I hope, we're causing our competitors some grief. We have withdrawn service from markets that didn't fit with our long-range objectives, and we have added new markets and new cities to our system, including some smaller cities. This July we plan to begin service to Grand Junction, Colorado, and Casper, Wyoming. All of this is as it should be.

The Board has also begun the process of deregulating rates, but so far the deregulation is all on the downward side where virtually complete pricing flexibility is now in place. It is time the Board granted us upward fare flexibility to match the downward flexibility and the route freedom we already have. If we are to let the forces of the marketplace work, this last vestige of regulatory control must be removed. The time to get that process started is now.

The Board's decision to permit us to raise fares by up to 30 percent in markets over 400 miles is a welcome step, but they haven't gone far enough. As we said in our comments to the Board—I enclose a copy—it is time to experiment with total upward flexibility. The Board's pricing jurisdiction expires at the end of 1982. If we are given upward flexibility now, you and the Board will have an opportunity to observe our behavior in a market environment.

You have nothing to fear. Current economic conditions require us to move cautiously. As we observed in our comments, "The carriers are extremely sensitive to slackening demand and would be unlikely to further discourage demand by imposing unacceptably high prices on an already nervous public. Moreover, there are enough actual and potential competitors in practically every market to prevent monopolistic pricing policies from bearing fruit."

I also do not see any reason to differentiate pricing flexibility by the length of haul of the markets. I believe that whatever flexibility is provided should apply uniformly.

Thanks for considering my thoughts.

Sincerely,

A. L. FELDMAN.

Enclosure.

COMMENTS OF CONTINENTAL AIR LINES, INC. ON PSDR-66

Although it will comment on each of the Board's proposed options, Continental Air Lines, Inc. (Continental) urges the immediate implementation of a policy of full upward fare flexibility in all markets. There is no legal impediment to the adoption of such a policy, and it clearly is one whose time has come.

1. The Board should adopt a policy of permitting full upward fare flexibility in all markets

Before getting to the reasons for a policy of full upward fare flexibility, let's dispose of the legal argument. There is no legal impediment to such a policy. The statutory non-suspend zone is simply a Congressional command to the Board to keep its hands off fares falling within the zone. While the statute prohibits the Board from narrowing the zone, it does not prohibit the Board from exercising its discretion and expanding the zone. Indeed, the Board has already expanded the zone down to zero by accepting virtually every discount proposed, including games of chance. In truth, there is no downward zone remaining. And, just as there is no legal barrier to a policy of full downward flexibility, there is no barrier to full upward flexibility. The principle is the same.

Now, to the reasons for the policy. As just noted, the Board has lowered the fare floor to zero by permitting virtually every proposed discount to become effective, including coupons and games of chance. It has opened the domestic route system to all qualified comers, and it has made multiple entry awards of authority in just about every domestic market that anyone can think of. If there is a market left somewhere, there is no question but that the Board would do its best to open it up immediately. Domestic route deregulation has arrived. Or, as the Board put it, "[i]t can be plausibly argued that the domestic airline system is now almost as competitive as it will be after sunset" (PSDR—66, p. 3).

The situation today is that we have route deregulation and downward price deregulation, but tightly controlled upward pricing. This doesn't make sense. The Board cannot be committed to route deregulation and full downward pricing and at the same time keep restraints on upward pricing, because that denies the very purpose and accomplishments of deregulation. The current upward pricing policy is a holdover from a paternal regulatory system which should be discarded.

An argument for retaining a system of upward price control has to be premised on the belief that the airlines are stupid enough to price themselves out of the marketplace. Not only is there no evidence to support such a belief, but also the current economic climate creates natural constraints on any desire for excessively high prices. The carriers are extremely sensitive to slackening demand and would be unlikely to further discourage demand by imposing unacceptably high prices on an already nervous public. Moreover, there are enough actual and potential competitors in practically every market to prevent monopolistic pricing policies from bearing fruit.

Complete upward pricing flexibility would enable to carriers to react to extraordinary cost charges in a timely fashion without having to wait for the Board to set up new procedures or to modify the SIFL methodology in an attempt to cope with the situation. The timing of fare increases is about as important as the amount of the increase, and this is a matter that should be judged by the carriers themselves. In this regard, the Board is concerned that the present SIFL adjustment procedure "facilitates tacit price coordination" (PSDR-66, p. 10). That may well be so, since the carriers know that fares will be adjusted six times a year on specific dates. Because each increase is a delayed reaction to prior cost increases and occurs with predictable regularity, the carriers tend to take the full amount of each increase at the same time. On the other hand, with full upward pricing flexibility, each carrier would determine how much to raise its fares and, more importantly, when. Some might even opt for seasonal increases which would promote peak/off-peak pricing. The point is that the Board should stand aside and let carrier managements make these determinations, just as it has left it up to the carriers to enter any market they choose or to lower their prices by any amount or to design advertising programs built around giveaway schemes.

Some might argue that to permit full upward fare flexibility is to ignore the Congressional desire to "phase in" deregulation, since the Board is not supposed to lose its jurisdiction over fares until January 1, 1983. That argument misses the point. The adoption of a policy permitting full upward fare flexibility still enables

the Board to monitor the results of the policy and to step in if unforeseen pricing abuses should occur. The Board would not be giving up its jurisdiction; it would be saying to the carriers that it will stand aside unless it detects monopoly pricing abuses. Continental does not believe that such abuses would arise, because virtually every market is capable of being entered by a potential competitor. We have no doubt that a competitor would enter a market if a monopolist were earning excessive profits. There are no real barriers to entry, and even those airports which are experiencing overcrowding are inhabited by a number of carriers that are fully capable of shifting their service to a city-pair which includes that busy hub as one of the points. Furthermore, except for a few isolated instances in California, no carrier has been denied access to an airport that it wants to enter.

In sum, Continental believes that there are no legitimate arguments favoring the retention of regulatory barriers to upward pricing. The Board should have enough confidence in the progress of deregulation to give the carriers the same flexibility to raise their fares as they have to lower them. The Board would not be relinquishing its jurisdiction; it would simply be saying that the carriers themselves should determine their pricing policies unless it could be shown that such policies result in monopoly pricing abuses. If abuses should occur—and we believe that there would be few or none—the Board could take appropriate measures through its investigatory powers.

2. Except for full downward flexibility, the other options retain unnecessary regulatory constraint

In addition to full upward flexibility, the Board has suggest five options of which four would retain varying degress of regulatory constraint. For that reason, Continental does not support any of these four options; however, in the event the Board is unwilling to allow full upward flexibility it should at least adopt option V which provides increases upward flexibility in all markets.

OPTION I: FULL DOWNWARD FLEXIBILITY IN ALL MARKETS

The Board recognizes that, as practical matter, it has already adopted a policy of full downward flexibility. In the Board's words, "[w]e have not suspended or investigated any fare reduction since passage of the ADA" (PSDR-66, p. 4). Continental supports full downward flexibility. But, we do not believe that the Board can legitimately endorse a policy of full downward flexibility and at the same time artificially restrain upward price adjustments. Gerrymandered deregulation is not what Congress has in mind.

OPTION II: 10 PERCENT UPWARD FLEXIBILITY FOR MORE MARKETS

The proposed limitation of 5 percent in monopoly markets is a needless regulatory constraint and is impossible to monitor. New authority is being granted at a rapid pace, and carriers are constantly moving in and out of markets. The Board had to abandon the 58 day limit for monopoly markets because it did not make sense, and this proposal carries with it the same infirmities.

OPTION III: FULL OR FULL/PARTIAL UPWARD FLEXIBILITY IN SHORT-HAUL MARKETS

This proposal is a regulatory tool to encourage carriers to stay in short-haul markets. That is fine as fare as it goes, but there is no reason to restrain upward pricing by flight stage length. This option simply shifts the fare curve closer to the cost curve in the short-haul markets, but preserves the DPFI fare curve for the remainder of the industry.[1] Continental can see no reason why the DPFI fare curve should remain sacrosanct and subject only to minor tinkering by the agency.

OPTION IV: FULL UPWARD FLEXIBILITY FOR A PORTION OF EACH CARRIER'S AVAILABLE SEAT-MILES

On the surface, this idea has some appeal. Its most appealing feature is that it would lead to total upward flexibility one year before the Board's pricing jurisdiction expires. And, the concept also appears to make peak/off-peak pricing schemes more feasible. However, the proposal requires more monitoring and more regulatory intereference, and it would lead to confusion.

Carriers are admonished constantly by the travel industry not to complicate their fare structures because the computer and fare quote systems now in place are not sophisticated enough to handle the burgeoning variety of fares. For example, when

[1] The cross-over point between fares and costs occurs at 400 miles (PSDR-66, App. C) and for this reason a proposal confined to 200 mile markets would still leave many fares below cost.

Continental introduced peak/off-peak pricing in Hawaii and Las Vegas, it was criticized by the travel industry because those fares did not follow a standardized code and could not be easily understood by the travel agents. We have found that peak/off-peak fares require a standardized class of service and well recognized fare-basis codes if they are to be used by the travel industry. For that reason, the carriers must have the flexibility to determine how the 25 percent limitation should be applied. Carriers should have the discretion to apply the seat-mile limitation on a system basis rather than by market and on a seasonal, monthly or quarterly basis rather than weekly. This flexibility would enable the carriers to implement and monitor peak/off-peak pricing more effectively.

OPTION V: INCREASED UPWARD FLEXIBILITY IN ALL MARKETS

This is a decidedly second best alternative to full upward flexibility. It has the advantage of permitting the carriers to determine both the timing and amount of their fare increases, which would promote greater price competition. Its disadvantage is that it would require continued Board involvement in making SIFL adjustments to what is essentially the old DPFI fare curve. We see no reason for the Board to engage in this activity, particularly since the resulting level of fares would probably be the same whether the industry moves to full upward flexibility or retains a 30 percent ceiling plus two annual SIFL adjustments.[2] This comes back to a point which we made earlier, namely that the carriers are not going to price themselves out of the marketplace with excessive fare increases. That is why Continental supports a policy of full upward flexibility. Having deregulated domestic entry, the Board should now let the marketplace determine the upper level of prices as well as the lower level.

COMMUTER AIRLINE ASSOCIATION OF AMERICA, WASHINGTON, D.C.
May 19, 1980

Hon. HOWARD W. CANNON,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR CANNON: The Commuter Airline Association of America (CAAA) shares your concern that the Civil Aeronautics Board may be attempting to cure the market irregularities that have resulted from fare regulation by creating new distortions. We are concerned that totally deregulating short haul fares while long haul fares are still regulated, will create imbalances in the short haul markets.

In our enclosed comments on the Proposed Fare Policies, CAAA supports the Board's proposal to liberalize fare policies, but suggests that liberalization in fare policies should be equitably applied to all markets.

Sincerely,

DUAN H. EKEDAHL, *President*

Enclosure

COMMENTS OF COMMUTER AIRLINE ASSOCIATION OF AMERICA

In the above notice of proposed rulemaking, the Board is proposing several options for modifying its fare policies. The Commuter Airline Association of America (CAAA) hereby comments on these proposals.[1]

1. In light of the expiration of the Board's domestic passenger fare and rate jurisdiction on January 1, 1983, pursuant to the Airline Deregulation Act, the Board is proposing several alternative options for liberalizing its fare policies in order to provide for a smooth transition to the point where regulatory constraints on prices will be eliminated. CAAA concurs that the Board should be moving in the direction of fare deregulation in order to provide for a smooth transition.

In selecting an option or options for such transition, however, the Board should be careful not to select one which will result in new distortions of the competitive marketplace. The Board should also consider the relationship of any option selected to the issue of subsidy. Many commuters compete in markets served by subsidized local service carriers, including markets where the local service carriers receive additional subsidy called service incentive payments. The Board should insure that

[2] For example, during 1979 fares increased by about 33 percent, including the SIFL adjustments plus the limited upward flexibility then permitted.

[1] Representatives of AeroMech, Inc., Altair Airlines, Air Wisconsin, Inc., Command Airways, Inc., Imperial Airlines, Mississippi Valley Airlines, Inc., Pocono Airlines, Inc., Provincetown Boston and Naples Airlines, Rio Airways, Royal Hawaiian Air Service, and Swift Aire Lines on CAAA's Board of Directors have approved the filing of these comments.

any additional fare freedom granted should not be combinable with subsidy in a manner which results in unfair competition.

2. CAAA supports Option I which provides for full downward fare flexibility. This option simply ratifies the *de facto* situation that presently exists. The Board will retain jurisdiction to intervene in any situations which involve predation.

3. Options II through VI in the Board notice propose various alternative options for upward fare flexibility, including complete upward flexibility in all markets. CAAA believes there is merit in Option VI, full upward fare flexibility in all markets, in view of the fact that there is presently virtually free entry in the route area. Such constraints as presently exist on route entry are mostly of a nature which will not be eliminated when the Board's control over route entry ends on December 31, 1981. Thus, route entry is about as free as it will ever be. It is anomalous to continue rigid fare regulation when free entry exists in the route area. The Board will still retain jurisdiction over fares, pursuant to which it can deal with any egregious situations that may develop. It follows from the foregoing position that CAAA would support any degree of lesser fare regulation which does not introduce new distortions in the marketplace. Hence, CAAA could support Options II and IV and Option V to the extent it provides the same level of fare flexibility in all markets.

4. The Board's Option III proposes full upward fare flexibility in markets up to 200 miles and additional fare flexibility of up to 30 percent, 50 percent, or unlimited fare flexibility in markest of 200–400 miles. The Board's thesis is that the present DPFI based fare structure is driving larger carriers from these short-haul markets. The Board believes that the DPFI fare structure has created an incentive to serve long-haul markets. CAAA is concerned, however, that this option will create the exact opposite distortion in the marketplace. If short-haul fares are totally deregulated and long-haul fares remain regulated, this creates a marketplace distortion in favor of serving short-haul markets. The Board should not attempt to cure one distortion by creating another.[4] Any liberalization in fare policies should be equitably applied to all markets. Any new fare policies should move toward eliminating such distortions instead of introducing new distortions by deregulating short-haul fares while continuing to regulate long-haul fares.

ASSOCIATION OF LOCAL TRANSPORT AIRLINES,
Washington, DC, May 19, 1980

Hon. HOWARD W. CANNON,
Chairman, Commerce, Science, and Transportation Committee,
U.S. Senate, Washington, DC.

DEAR CHAIRMAN CANNON: I am writing you as Executive Director of the Association of Local Transport Airlines, concerning the recent action of the CAB increasing fare flexibility. We understand that concern has been expressed by various members of Congress about the Board action.

In our view, the Board's decision was consistent with the spirit of the Airline Deregulation Act of 1978. It will, in the long run, result in more satisfactory short-haul and small city air service than otherwise. The Board's decision simply recognizes that resort to the market-place, rather than rigid regulatory constraints, is the most efficient and economical way to deal with rapidly rising fuel and other costs which are having a proportionally heavier impact in short-haul transportation. Unless carriers are given the flexibility to adjust fares to meet these cost increases, economic principles will force short-haul services to suffer. As you know, a large percentage of flights under 200 miles serve small cities.

There is no reason to believe, however, that carriers will take undue advantage of this flexibility and attempt to extract unreasonably high fares from short-haul passengers. Competition with other airlines and good highway transportation makes it impractical. Traditionally, the local service carriers have been free to set their fares at 130 percent of the recognizable coach fare. Because of the risk of traffic loss, carriers have not taken full advantage of this higher ceiling—even though their costs have more than justified doing so.

Like all airlines, the ALTA members are dismayed by the recent steep increases in fuel and related costs. Retention of strict regulatory restraints on the carriers'

[4] At page 6 of its notice the Board states that "it makes no sense to perpetuate fare ceilings that drive out certificated carriers in favor of unregulated commuters who charge more." While this statement may have been meant purely theoretically, it is incorrect as a matter of fact as Appendix A to the Board's notice demonstrates. That Appendix shows that in short-haul monopoly markets a greater proportion of the fares of commuters are at or below the Standard Industry Fare Level than is the case with certificated carriers.

ability to meet these costs imposes an unacceptable economic burden. To its credit, the CAB has recognized the special problems of short-haul transportation and has seen the close connection between fare regulation and preservation of small city services.

The CAB, the Congress and the public, also, have every right to expect that this additional fare flexibility will be used cautiously and responsibly. I can assure you that this is our intention.

Sincerely,

JOHN L. ZORACK, *Executive Director.*

ASSOCIATION OF LOCAL TRANSPORT AIRLINES,
Washington, D.C., May 19, 1980.

Hon. HOWARD W. CANNON,
Chairman, Commerce, Science, and Transportation Committee,
U.S. Senate, Washington, D.C.

DEAR CHAIRMAN CANNON: This is to advise you that USAir, Inc., does not join in the ALTA letter, dated May 19, 1980, having expressed its views on fare flexibility in its comments with respect to PSDR-66, Domestic Passenger Fare Flexibility Options, Docket No. 37982.

Sincerely yours,

JOHN L. ZORACK, *Executive Director.*

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